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2016: "PEAK DEVASTATION" FOR ENERGY

THE 20-YEAR RECORD FOR GOLD

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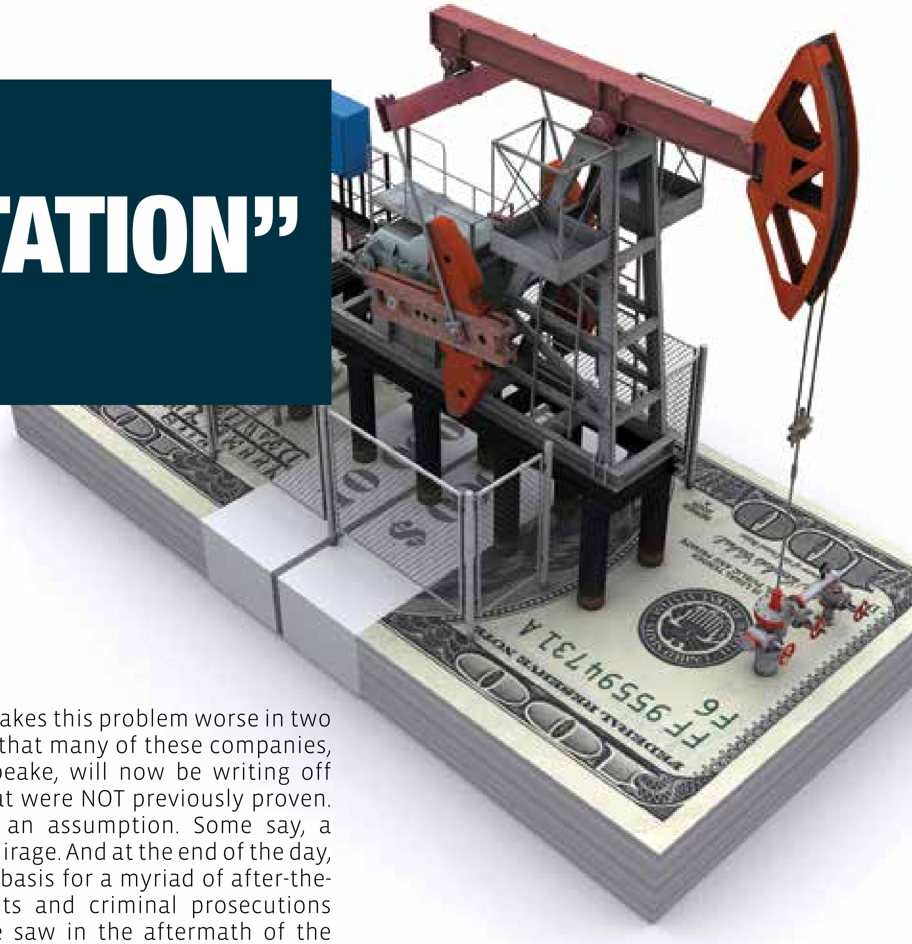
2016: “PEAK DEVASTATION” FOR ENERGY



By Chris Temple

It wasn’t that many years ago that the world was wrestling with legitimate worries over so-called “peak oil.” Then came the U.S. shale boom. The narrative did a “180.” Now, we think, America is swimming in so much cheap oil (and natural gas) that will be around for decades that tens of billions of dollars are being committed to build export markets. Who’d a thunk it!? Natural gas is being compressed and supposedly America and Canada alike will be sending gas overseas. As for crude oil, there is a not-insignificant move in Washington to remove export restrictions on U.S. producers so they can ship crude oil abroad as well.

Few understand, though, that--a year or two from now--we will be taking a big step back toward those “peak oil” worries. At the least, present, price-crushing worries about oversupply will be gone. The trouble is--as the pendulum swings back that way--a lot of damage is going to be done.

Late last week, Bloomberg ran this story: *http://www.bloomberg.com/news/articles/2015-12-10/billions-of-barrels-of-oil-vanish-in-a-puff-of-accounting-smoke*. I doubt there is a more important story--together with its accompanying story line--that investors can be aware of right now.

That a significant player in the shale boom of recent years will be required in one fell swoop to admit that nearly half of the energy assets that investors, bankers, regulators and others thought existed NEVER DID EXIST is staggering. And Chesapeake will not be alone.

And this is not your garden-variety write down of previously-proven assets that occurs with any resource after a prolonged price decline. That’s all bad enough when it comes to oil (and gas) as it makes it that much harder for companies to keep existing credit lines, let alone get new ones. It’s why at the end of a downturn you see fire sales of assets, well shut-ins, a collapse of capital spending and some bankruptcies sprinkled into the mix. That’s all normal; and that alone where the present energy downturn is concerned is probably enough--given the debt loads involved--to lead to enough casualties among energy companies that will spread to hedge funds, banks, and the broad financial markets.

But what makes this problem worse in two respects is that many of these companies, like Chesapeake, will now be writing off “assets” that were NOT previously proven. They were an assumption. Some say, a complete mirage. And at the end of the day, a probable basis for a myriad of after-the-fact lawsuits and criminal prosecutions such as we saw in the aftermath of the mortgage/real estate bust. And just like then, nobody at the Fed or the big banks that enabled and fostered all of this will be among the targets. (NOTE: For those of you who are new to these pages and/or have never watched, check out my little “seminar” on my You Tube channel from over a year ago, when I showed you step-by-step what led to the 2008 blowup and then predicted that a likely cause of the next one would be the new debt-fueled energy “boom.” It’s at *https://www.youtube.com/watch?v=KxTMoiJAhZk*)

Few understand, though, that–a year or two from now–we will be taking a big step back toward those “peak oil” worries.

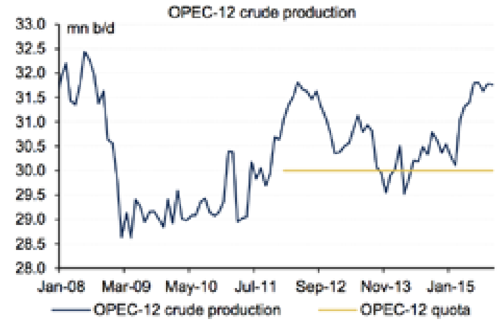
When all is said and done, we will have presently-unknowable (but I suspect considerable) damage to the broad markets, the banking system and more. We have not seen much of this so far for a few reasons. Chief among them is that a great many companies have not been selling their crude oil for $40 a barrel or thereabouts during 2015 but were able to hedge/sell forward their production (or a good chunk of it) at higher prices before the big collapse. For many companies, the new year will bring with it the end of those contracts; and the end of selling their production for, perhaps, $60-$70 per barrel. That will intensify the financial pressure, and likely mark 2016 as a year of “peak devastation” for energy companies and perhaps the credit markets. ***Beyond the evolving financial turmoil looms a bigger issue.*** Simply put, a lot of plans for the future have been made by energy companies, non-energy companies and our country as a whole based on the notion of this virtually endless, cheap shale-housed source of energy for decades to come. You know where I have stood on this. On my “Other Experts” page as well I have been carrying a few well-documented and thoughtful commentaries by others as well on what some call an outright financial scam. However you look at it, America--not just the markets--is in for a very rude awakening as we return to the reality that we DON’T have surplus energy to export and that a creaky economy WON’T be getting added help any longer from such cheap energy as we have seen in the recent past thanks to the overproduction fostered by greedy companies and their financers.

On the way to that point, though, the present “reality” continues to be punctuated by continuing oversupply and the battle to “maintain market share.” Like it or not, most producers have been dragged by Saudi Arabia into that old saw, “Yes, I’m losing money on my product. But I’ll make it up on volume.”

At its latest confab, O.P.E.C. pretty much ratified its recent 2 million barrel per day overproduction above its official target as a de facto new target. U.S. production in 2015 has declined only marginally, thanks to those hedges as well as to banks and others who until now have been willing to throw good money after bad, hope for the best and keep their zombie clients afloat until better days arrive. (That latter will be a lot harder to do in 2016 unless the bankers and other investors want to get in line for when the prosecutions commence.) Production aside from Saudi Arabia in the Middle East is slated to increase of all things, both from Iraq and Iran.

Appropriately, the International Energy Agency is warning that the supply/demand imbalance could get worse before it gets better going toward 2017. The irony here--and a lesson in what could have been if market forces were at work all along and not skewed by all that cheap credit--is that demand has continued to rise globally at a decent pace despite the global economic slowdown. 2015 will end with somewhere in the neighborhood of a 1.5 million barrel per day increase over 2014. That might slow to about 1 million barrels per day in 2016. What is not being used by industry has been more than made up for by brisk increases in gasoline demand, most notably in China and the U.S. But again--as with the mortgage crisis of several years ago--the present problem and the dominoes that will fall were caused by finance.

Chart 3: Production of OPEC-12 is 1.8 million b/d above the cartel's official ceiling on a continuous production ramp-up in 2015



Source: IEA, BofA Merrill Lynch Commodities Research

In the end, the Saudis are likely to get their way and achieve their objectives; but every bit as much due to the inherent debt issues among America's energy companies leading to a 2016 plunge in production in the U.S. One remaining question is what kind of devastation we will see outside of America's shale oil (and gas) patch; such as a financial breakdown or major unrest in an oil exporter that doesn't have the piggy bank it can blow as do the Saudis in this quest to destroy competitors. Time will tell.

Though there may be a respite if an especially dovish Fed causes big counter trend rallies in energy and energy stocks (and I may advocate trading into them, as I've already suggested) the worst of the damage is still ahead of us. There will be perhaps a few trades of various kinds on both sides of this story as we near the climax over the next year, give or take. ***And in addition to that, there will come a generational opportunity to load up on the survivors of this; those companies that will be part of a considerably trimmed stable that will bring us energy into the future.***

For Chris Temple's complete 2016 forecast commentary on all the markets, drop him a line at chris@nationalinvestor.com

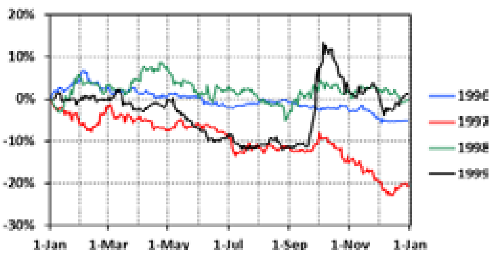
THE 20-YEAR RECORD FOR GOLD

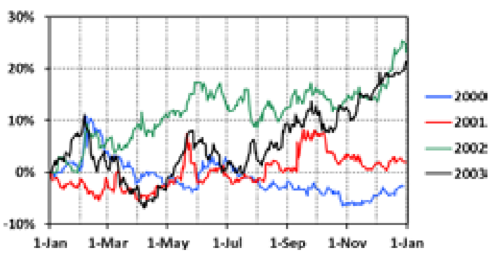
By Micky Fulp

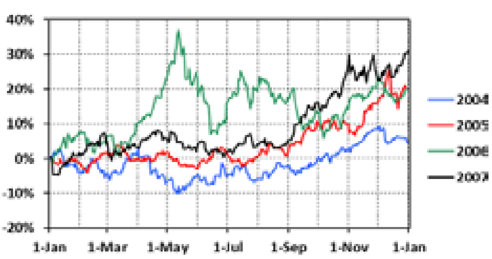
My recent work has focused on seasonality of the gold price (Mercenary Musings: October 19; October 26; November 23). Today, I present new research covering a 20-year time frame from 1996-2015 that includes a 12-year bull market for gold from 2001-2012 bracketed by bear markets in the late 1990s and mid-2010s.

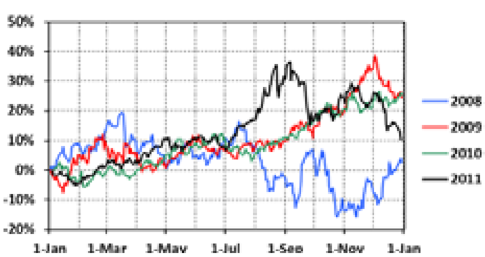
In a series of normalized charts, I will show that regardless of overall year-over-year bull or bear market conditions, there are predictable intra-year trends in the gold price.

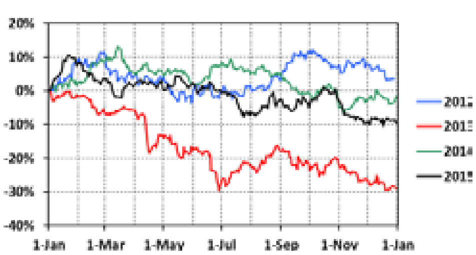
The first series of charts shows the percentage change in the daily gold price normalized to January 1 for each year from 1996 to 2015. Please note that all gold prices are London afternoon close:









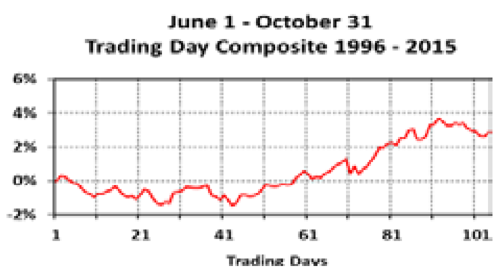


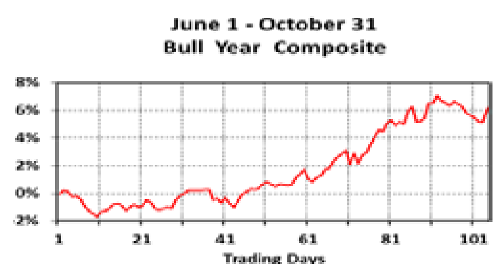
Based on data tabulated below, we define bull years for gold (black) as those in which the price closed the year higher than it opened and bear market years (red) as those in which the price closed the year lower than it opened. In 1998, gold closed the year 40 cents lower so the percentage change rounds off to zero:

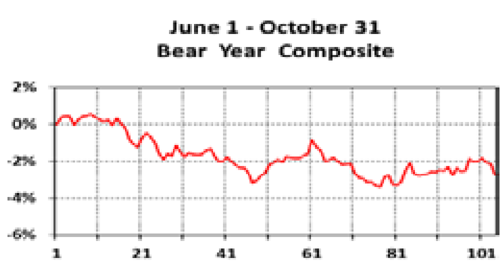
Gold $ / Oz

Year	Jan Open	Dec Close	% Change
Year	Jan Open	Dec Close	% Change
1996	394	369	6.3
1997	359	290	19.2
1998	288	288	0.0
1999	287	291	1.4
2000	282	274	2.8
2001	271	277	2.2
2002	278	347	24.8
2003	344	416	19.1
2004	416	436	4.8
2005	428	513	19.9
2006	530	632	19.2
2007	640	834	30.1
2008	847	870	2.6
2009	875	1088	24.3
2010	1122	1406	25.3
2011	1389	1531	10.2
2012	1598	1658	3.8
2013	1694	1205	28.9
2014	1225	1206	1.6
2015	1172	1061	9.4

The following three charts present composite seasonal trends from June 1 to October 31 for the entire 20-year period, bear years (1996-1998; 2000; 2013-2015) and bull years (1999; 2001-2012):

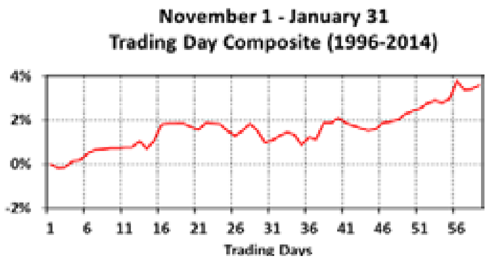




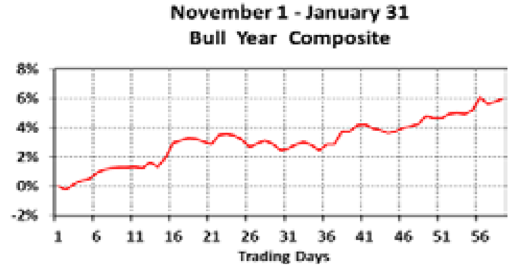


The 20-year composite chart expands upon the seasonal trend documented in a previous missive (Mercenary Musing, October 26): an early June 1 high followed by lows during the summer doldrums with a mid-August rally that continues through mid-October. Separating bear and bull cases shows some interesting divergence. In bull market years, the summer doldrums begin earlier and are less pronounced and gold goes on the uptick by early August. In bear markets, the August rally is short-lived to Labor Day and the October rise is choppy and of less magnitude.

Next up is the second seasonal period from November 1 to January 31 that we considered previously (Mercenary Musing November 23). Here are the composite 20-year, bull market, and bear market charts:



For the 20-year composite, the gold price trend is mostly up. Gold goes higher thru late November as physical demand peaks, trades flat thru the holidays, and rallies strongly for most of January.



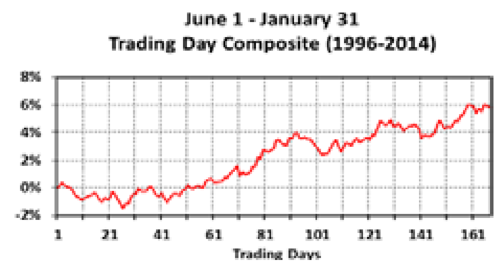
If we examine bull and bear cases independently, the patterns are once again significantly different. In bull market years, the gold price mimics the overall trend but the amplitudes are much higher (note y- axis scale change).

In bear years, the gold price falls in November thru early January with a notable price spike in early December. The seasonal rally does not begin until end of the second week of the new year and though muted in amplitude, remains intact for the remainder of the month.

LET'S REVIEW:

- Over a 20-year time frame, there is an intra-year seasonality of the gold price from June 1 to October 31 and November 1 to January 31.
- From June 1 to October 31, gold reaches a seasonal low during the summer doldrums and rallies after Labor Day and thru most of October.
- From November 1 to January 31, gold rises in bull and falls in bear markets during November and December, and rallies strongly in January in both cases.
- Although there are notable differences in timing and amplitude of rises or falls in the gold price during bull and bear market years, overall seasonal trends occur no matter the prevailing market conditions.

Here's a composite price chart that can be used to time buys and/or sells of gold:



IN CONCLUSION:

- Speculators and traders should buy paper gold and derivatives during the summer doldrums and sell in late January of the following year.

- Hoarders (like me) who accumulate gold as real money, a safe haven, and an insurance policy against financial calamity, should buy physical gold during the summer doldrums of any given year.

Acknowledgment: Steve Sweeney is the research assistant for *MercenaryGeologist.com* and compiled the data and charts.

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THE ONE RING: WHY **SILVER AND GOLD WILL RULE THEM ALL**

By David H. Smith

One of the most powerful movies ever made - which eventually became a trilogy - is The Lord of the Rings. In books and on the big screen, audiences flocked to the adventures of the Hobbits as they journeyed to the land of Mordor in an effort to destroy the One Ring before its power - in the wrong hands - could enslave Middle Earth. Of course, Bilbo Baggins himself was far from immune to the power of the ring, as it sought to "bend" his own morality toward the dark side.

Based upon a three volume work by J.R.R. Tolkien, the themes of bravery in the face of adversity, allegiance to duty, honor and personal growth, resonates with audiences around the world to the extent that it has become the 40th-highest grossing film of all time.

What's fascinating is that the idea of such a ring, which allows its wearer to become invisible, dates back to The Ring of Gyges, from Book II of Plato's Republic. In the telling of this tale, the issue was one of whether or not a man who possesses the ring would be able to act in a just way, when he knew that he could behave however he chose and not face a consequence. Plato's argument was that the man who abuses the power of the ring would become a slave to his own appetites, whereas the person who did not, would remain content and in control of himself.

One can see the significance of this argument because it looks at how people either constructively use, or abuse great wealth and power - and what a challenge it tends to be, even for those of us with the most self-control!

Be that as it may, and putting aside a discussion on the morality of finance - gold, silver or any other object does not in and of itself possess an ethical quality - because being either "good" or "bad" ultimately depends solely upon how that "object" is put to use.

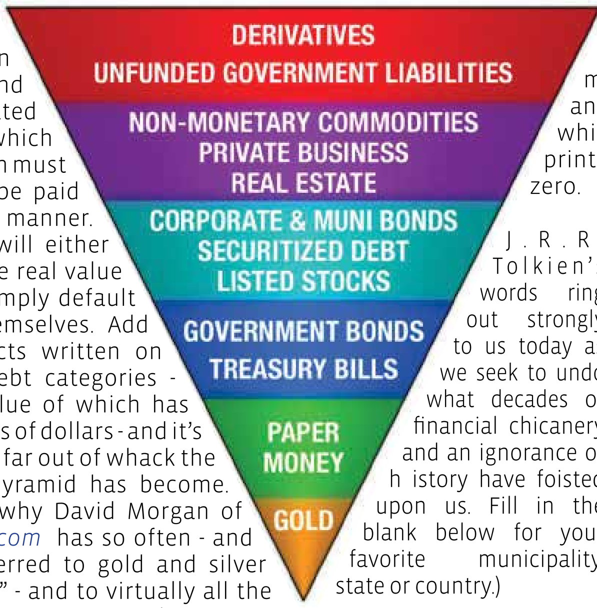
Today, I'd like you to consider a variation of the concept - a ring formed by the union of gold and silver into The One (Monetary) Ring, which would underlie and unite all other forms of financial exchange. Indeed their individual prices movements are over 90% correlated.

GOLD-AND-SILVER: "ONE-RING TO RULE THEM ALL"

John Exter, in his inverted pyramid (see Rock, Paper, Scissors: Why Gold and Silver will Always Prevail *here*), defined gold - and by implication silver - as the sole item upon which all other variations of financial instruments rested. Precious metals have no claim upon them other than by those who hold these metals at any given time. They can be exchanged for other goods and services, but their intrinsic value does not evolve from something else. In this light, ALL other instruments - paper currencies, corporate and government bonds, stocks, unfunded government liabilities and derivatives, even real estate - are simply by-products of what Exter called "Power Money" - gold (and silver).

EXTER'S INVERTED FINANCIAL PYRAMID

Nowadays, in Japan, the countries of the European Union, China, and especially in the U.S., underfunded government programs, pension funds and bond holdings have created a debt overhang which any rational person must admit can never be paid back in a normal manner. Instead, debtors will either "whittle down" the real value via inflation, or simply default on the debts themselves. Add derivative contracts written on many of these debt categories - the notational value of which has soared into trillions of dollars - and it's apparent just how far out of whack the global financial pyramid has become. Now do you see why David Morgan of themorganreport.com has so often - and so correctly - referred to gold and silver as "honest money" - and to virtually all the un-backed derivations resting above it as "paper promises"?



As it dawns on enough people that the sea of debt we've generated can never be repaid without hyperinflation or outright debt-repudiation, it's almost a given that gold and silver will be looked upon as the one underlying asset class which can restore fiscal responsibility and confidence to a financial system gravely distorted by mismanagement, short-sighted "decision-making", and simple greed.

Would this be a new concept? Of course not! Such an outcome has been seen many times throughout history, as virtually EVERY "experiment" with fiat currencies has failed due to the behavior of those who have corrupted them, in due time reducing the value of each sea of "paper promises" to no more than the ink and paper upon which they were printed - in effect - to zero.

J.R.R. Tolkien's words ring out strongly to us today as we seek to undo what decades of financial chicanery and an ignorance of h istory have foisted upon us. Fill in the blank below for your favorite municipality, state or country.)

One Ring to rule them all, One Ring to find them, One Ring to bring them all and in the darkness bind them In the Land of (______) Mordor where the Shadows lie.

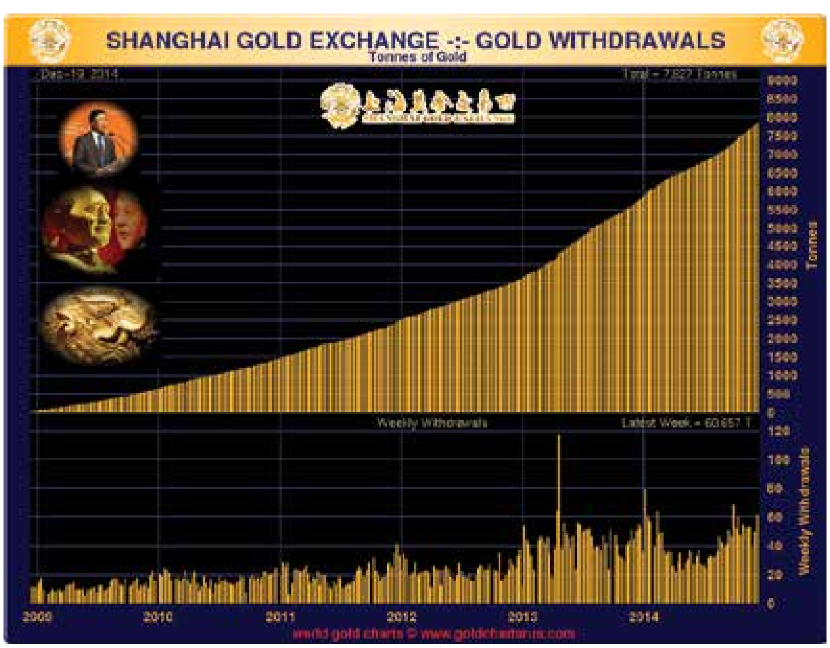
In 2011, for the first time in 20 years, European central banks became net buyers of gold, even as they continue to dismiss its utility in today's financial arena. Gee, I wonder why?

You can wait to find out the obvious answer, or make a decision now to hold your own supply of precious metals. Then sooner or later, just like the money-lenders themselves, you too will be able to "laugh all the way to the bank."

DISCLAIMER

David H. Smith is Senior Analyst for http://www.themorganreport.com/ and a regular contributor to moneymetals.com He has investigated precious metals mines and exploration sites in Argentina, Chile, Bolivia, Mexico, China, Canada, and the U.S. He shares his findings and investment perspective with readers, media listeners, and audiences at North American investment conferences. This essay is first appeared at moneymetals.com

> ***"Gold is the universal prize in all countries, all cultures and in all ages."***
> - Physicist and polymath, Jacob Bronowski, Ascent of Man



YELLEN COMES DOWN THE CHIMNEY

Seven years of zero interest rates have created plenty of capital misallocation, mal-investment and yield chasing. We've seen some minor debacles in the high yield space this month. Nothing earth shattering but certainly disquieting. Big problems often start small and go unnoticed until the tsunami is on the horizon. Keep an eye on bonds. The credit market funds a large percentage of the buying underpinned the bull market. We've got a problem if it stops.

So far at least, my call for the USD to show topping action around the first rate hike and for gold to put in some sort of bottom is correct. It's early days though. The belief that the $US is going much higher is still almost universal. I explain why I'm not sold on that idea below. We should all hope I'm right. If Wall St is correct and the USD index goes to 120 I can guarantee a recession in the US. It definitely won't be the "winner take all" play NY seems to envisage. The gold price hasn't moved yet but I think we're set up for at least a tradable rally soon which should make for a brighter 2016.

Enjoy your family and friends and let's look forward to a 2016 resource market (gold anyway) that provides a few opportunities and not just lots of pain!

Eric Coffin

They finally did it. It's amazing the amount of ink that has been and will be spilt (here too!) about something that seems so, well minor. In fact, lots of that spilt ink was used to explain how unimportant a 25bps rate hike is in the grand scheme of things. Except that it is important. Here's why.

It's not the one rate hike itself that matters obviously. 25bps is minor, especially when it's tacked onto, well, nothing. What's important is that it marks a sea change from the world's most important central bank shifting from being extremely accommodative to... To what exactly? Certainly not hawkish. That would be a stretch. But it is a change in direction to something less accommodative. From "loosening" to "tightening" at least at a generic level. That's important since a tightening trend is usually not the stock market's friend at least in theory.

Yellen tried hard to stay on everyone's "nice" list and did a pretty good job of it. She made repeated references to being guided by inflation expectations. While the dot plots supplied by FOMC members imply several rate hikes next year Wall St doesn't buy it. Few outside the Eccles building see the disinflation trend as "transitory" - another word that came up repeatedly in Yellen's press conference.

Yes, oil is a big factor and one of these days the oil price will start rising again. I don't know when but since we're over a year into the price fall already calling it "transitory" is a bit disingenuous. There should be a small inflation bump in early 2016 due to base effects—lower prices a year ago generating more stable looking CPI readings. But it won't move much unless some prices actually start rising.

Disinflationary forces are tied to the stronger USD of course. I seem to be the only one that thinks the US currency could be topping. If the Fed doesn't believe it either I don't know what they are basing their rosy assumptions on.

Ok, I do know. The Fed is assuming growth will accelerate, presumably because the Fed raising rates convinces the masses that "it's all good". Why else would the Fed raise rates? A shockingly large number of Wall St analysts bought that story hook, line and sinker. It's a nice story and I hope it's true but it doesn't bear much relation to recent reality.

The US is arguably the strongest advanced economy but it's hardly "strong" by longer term measures. Growth is ticking along at two percent and change. Not that impressive and, interestingly, the Fed lowered its estimates of growth going forward at the last meeting. Interesting but not too surprising since the FOMC has consistently overestimated future growth for this entire expansion.

Early this year when everyone else expected the Euro to drop to parity, or less, with the USD I called a € bottom because I believed the EU was on the winning side of a currency move. The weak Euro helped exporters in the EU just as the strong USD hurt those in the US.

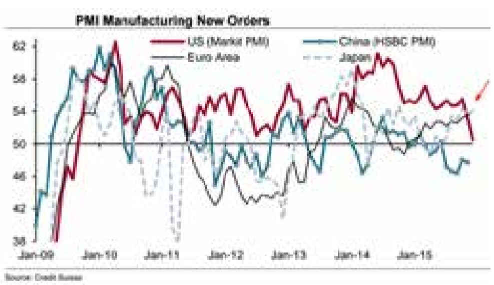
I have no doubt Mario Draghi would love to see the Euro fall further. It may be harder to engineer than Wall St thinks however.

Current weakness has been a boon and economic metrics across the continent have been strengthening.

Take a look at the chart below. It compares ISM manufacturing new orders readings for the US, EU Japan and China. There has been a distinct change of fortune over the past year or so.

ISM readings have been trending lower in the US for some time, and even service numbers are weakening now. Over the past few months similar readings have been strengthening in the EU and even in Japan. And, no, this isn't about oil. The surging USD is taking its toll.

China of course has worse problems, and some of the same causes. It may actually help the USD strengthen, for its own reasons. The Chinese Yuan was pegged to the USD and dragged up in its wake. Now that China has the SDR inclusion it craved it may feel less like keeping the peg. The bottom chart on the next page shows the CNY/USD exchange rate for the past year. As you can see, Beijing is letting the CNY weaken again and it's now surpassed the August low.



Keep in mind the CNY is still about 20% stronger than it was in 2009 so you can't say they haven't done their bit. China is well aware of the political ramifications of letting the Yuan weaken but its awful PMI numbers give them little choice.

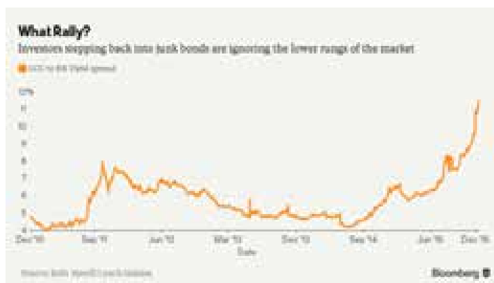
When the Fed raised rates there was a strong upward surge in the USD Index but it quickly flattened out. It has yet to test its high of early this year in the 102 range. It's certainly too early to say that won't happen but as I have noted before, nominal rate differentials are not the only driver.

If the EU block shows continued improvement it will be much tougher for Draghi to sell the idea of a broader QE program to the hawks on the ECB board. Likewise, if the Fed is actually right about core inflation picking up that will lower the real (inflation adjusted) interest rate and its real, not nominal, rates that drive yield seeking currency flows. The real rate differential between the US and the EU is much smaller than the nominal one.

So what does all this mean for the markets? A tightening rate trend should and will be reflected across the credit spectrum. That's normal and wouldn't matter much if we were in the early or mid-stages of an expansion but I think we can all agree we're in the late innings now.

I've commented before about my concerns about high yield and junk debt. Those concerns increased since the last issue when three small mutual and hedge funds focused on risky credits restricted redemptions. All the funds in question are small by Wall St standards. This is not "Lehman 2.0" It's not meaningless either, however much most of Wall St is downplaying it.

Problems in the credit market always show first at the risky end of the spectrum. That's how it should be. The question now is whether it spreads. I wouldn't assume it doesn't given the weakening margins and USD headwinds so many sectors are now facing. Again, this is not just about oil.



The chart above shows the spread between CCC and BB credits. It's blown out way beyond the extremes during the 2011 Euro crisis. This is not good and the problems may be spreading.

The chart below compares the level of share buybacks to the HY credit spread (inverted). The inverse correlation isn't perfect but buybacks do seem to follow the strength of the credit markets. This makes sense as much of the monies used for buybacks and leveraged buyouts is sourced in the debt markets. That matters. A lot of the upside volume in the past 3-4 years is directly attributable to these two items. If liquidity is drying up on the credit side we've lost one of the main underpinnings of the NY markets.

The major markets have been counting on a Santa Claus rally and Fed feel good to carry the day. The yearend rally is mainly about fund window dressing, not fundamentals, and is one of the most dependable seasonal moves. That said, it hasn't arrived yet. If we don't see a significant rally through yearend on the S&P traders should definitely get defensive. I would consider a failed "Santa" rally a very bad sign.

NY has now put in a couple of lower lows, even with the Fed following the bullish script. Junk bonds got a bounce after the "redemption scare" but it isn't holding as this is written. Most of the commentary I'm seeing is bullish but the average stock in NY is almost in a bear market. The rally continues to narrow. These are all negative signs. Hope for the best but prepare for the worst. I think we have rough sailing ahead.

So far (yes, it's only three days…) the USD is not holding its gains and gold is strengthening post-Fed as I had expected. I'm about the only one who did expect that so I won't be offended if you don't find my belief alone convincing. I'm sticking to that call however. The strong dollar meme is universally accepted but also very crowded. If NY gets weak it will be a tougher trade to stay in.

The short gold trade is even more crowded. Current COT positioning is the most bullish it has been in the past 15 years. I'll repeat that. Gold positioning is the most bullish it's been in 15 years. The potential for a sizable short covering rally is very good. If the USD meme changes on the back of that as I expect we may finally have the bottom we've waited for. Most traders are still waiting to see a "trigger" for that move. If the S&P really rolls over as I think it may soon, that could well be it. Gold could be the place to be again very soon.