

Today's Notes:

1. **Britain: Energy Sense**
2. **The AIG Sink Hole**

1. BRITAIN: ENERGY SENSE

No one really knows how the global energy system will finally “shake out.” We do have a few facts at our disposal however:

- 1) Venezuela's heavy oil largesse will be used increasingly as a geopolitical weapon by President Chavez once oil prices climb. The Venezuelan resources will be developed either by China or Russia.
- 2) Russia's natural gas largesse will be used increasingly as a geopolitical tool, not only for Eastern European countries in its sphere but also to bring the EU to “heel.”
- 3) China and the new Asian Sphere are moving rapidly to secure energy sources of all types. They are particularly focused on oil, gas, coal and transportation sensitive fuels.
- 4) Almost everywhere in the world (except the US) nuclear development is booming. Britain, Sweden, China, Russia and yes even the Green Germans, shaken after being forced to genuflect to Russia's Mr. Putin natural gas muscle, are considering a nuclear renaissance. France is far ahead on this issue and Mr. Sarkozy can now thumb his Gallic nose at Moscow if he wishes and lead in Europe. Nuclear has made France almost energy impendent.
- 5) One third of all natural gas burned today in the United States has been discovered in the past two decades. Natural gas to diesel is a realistic, reasonably clean, and near term solution to dependence on Messrs. Ahmadinejad, Chavez and Putin.
- 6) Resource nationalism – particularly in energy related resources - is growing daily in South America. The real friend the USA has exists North of the 49th parallel in Canada. Bashing the oil sands is the wrong strategy.
- 7) Contango's on WTI crude are narrowing. Sooner than we hope oil prices will head north once again. Without a coordinated and diversified energy policy the Obama Administration will be more dependent than ever on conflicts in the Middle East by the second half of his term.
- 8) What might prices of \$70 per barrel oil do to the 3% to 4% GDP growth forecasts in the current White House budget?

These issues, and more, speak to a reality. Alternative energy technologies cannot, by themselves, replace fossil fuels en masse for the next few decades. In that time my beautiful granddaughter Lucy will be thirty years old and her quality of life will be impacted by energy costs that are much higher than necessary.

Britain must see this “writing” on the wall. Her North Sea oil and gas reserves are dwindling. She does not want to be caught in the web that Russia is spinning for the Eastern European and EU countries. Germany has little choice in the short run. The US is rapidly walking into an energy deficit conundrum of her own making.

Last Wednesday Britain’s energy secretary Ed Miliband announced the building of a clean coal (CCS and carbon sequestration) in his Yorkshire riding. Three companies are vying for the business, two of them are German conglomerates and Scottish Power. The plan was to have a clean coal pilot plant up and running by 2015 – s short 5 years from now. This means that Britain is backing the building of new coal plants and will make a decision soon on whether these must have expensive, climate-friendly technologies fitted called carbon capture and storage (CCS).

“The energy mix will change by 2015 as existing coal and oil plants close,” Mike O’Brien, minister of state for department of energy and climate control, said at the McCloskey Coal UK Conference. *“We will need new fossil fuel plants including coal if we are going to maintain diversity in energy mix and energy security. That’s why CCS is a key technology for the UK and the global community,”* he said.

One sentence in this quote struck me. Mr. O’Brien said,

“... maintain and diversify in energy mix and energy security ...”

We castigated the Brits (current PM Gordon Brown) for selling gold at the low but it seems like common energy sense has prevailed in Britain. It is wonderful what a crisis in the near denial of energy (e.g. Russia’s shutoff of gas to Europe) will do to change the mindset.

By the way, guess whose buying American Met coal now? The Russians, that’s who. Pravda announced today that they will pay \$2.5 billion for the Jones family coal holdings in the US. When will Americans have their energy epiphany?

Please write your Senators and Congressman on this issue.

2. AIG: MONEY VORTEX

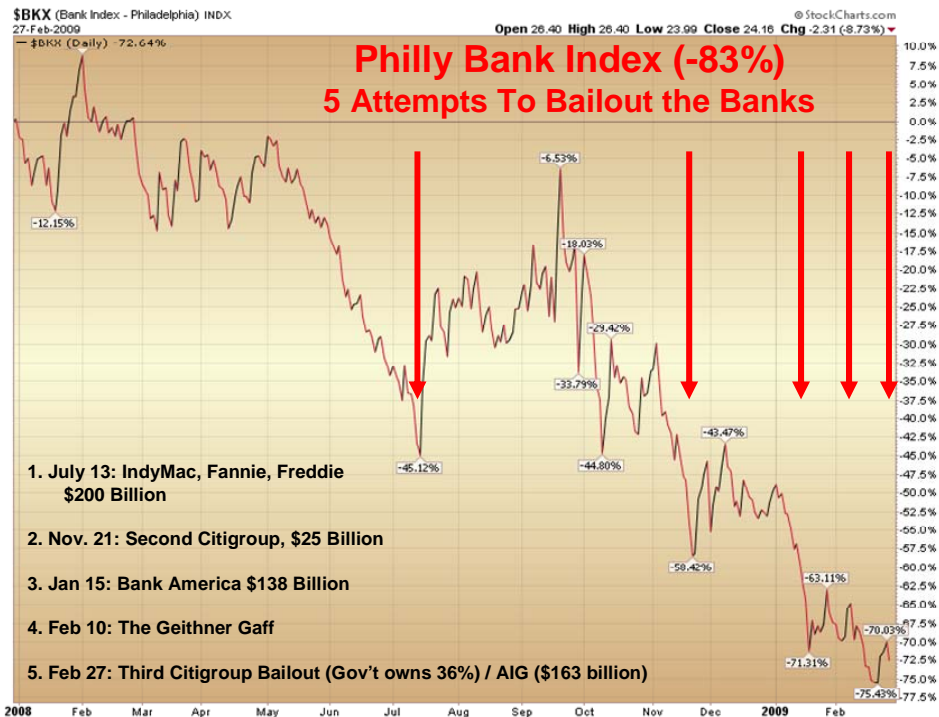
When will this endless money vortex end? AIG received another \$30 billion equity infusion from the TARP program to stay alive. The government owns slightly less than 80% of what once was the world’s largest insurer. Any further ownership and the taxpayer will be on the hook for the millions of individual insurance policies. The government has now either injected or loaned somewhere between \$163 billion and \$180 billion to the insurer. This is the full extent of the taxpayer’s exposure.

This AM the company announced a fourth quarter loss of \$61.7 billion. The full year 2008 loss is now mounting at \$99.3 billion (\$.1 trillion!). AIG's CEO, Edward Liddy, says that severe illiquidity was the problem in September. This AM he suggested on Bloomberg TV that the company now only needs enough equity to support the debt. He believes that with this injection the company can survive. Mr. Liddy was very direct in placing blame for the problems of the company squarely on the shoulders of former CEO Hank Greenberg. He believes that the company's credit default swap business (\$65 trillion notional value) and the compensation structure, both instigated under former CEO Greenberg, are to blame for the woes. The \$30 billion infusion will allow Moody's to leave the all-important AIG credit rating untouched. This was a key outcome not only for the company but for the entire global banking system.

I have been castigated from some readers for being too bearish – “all doom and gloom,” was one reader's comments to me last week. Others think I am too optimistic. Nevertheless, I have to call it the way I see it. The government could not let AIG go bankrupt. The Lehman bankruptcy was a crime perpetrated by then NY Fed Chief Timothy Geithner perhaps with support of Treasury Secretary Paulson. What worries me most is the continual decline of the Philadelphia Bank (equity) index. It has fallen 83% in 13 months despite repeated rescue attempts that have become known as “bailouts.” This cannot be a good harbinger of the policies that both the Republicans and the Democrats have enacted to save our faltering financial system.

Some have suggested that instead of being so gloomy I should suggest corrective measures. Unfortunately I do not know of any such measures. Apparently neither do the solons in Washington. Mom and pop are increasingly on the hook for the rescue of the financial system. Our leaders tried “ring fencing” toxic assets. This strategy didn't work because assets continued to turn toxic quicker than the fence could be expanded. We talked about the idea of a bad bank. Treasury just couldn't figure out how to do that. Recently the idea of bank nationalization has been floated a la Sweden. Fed Chief Bernanke rejected that alternative out of hand last week. So I suppose the bleeding will simply continue until it stops.

But there are courses of action. I have written for two years, December 2007, to raise cash and hold gold exposure. This is what I continue to suggest as a positive step under the current very tough circumstances.



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