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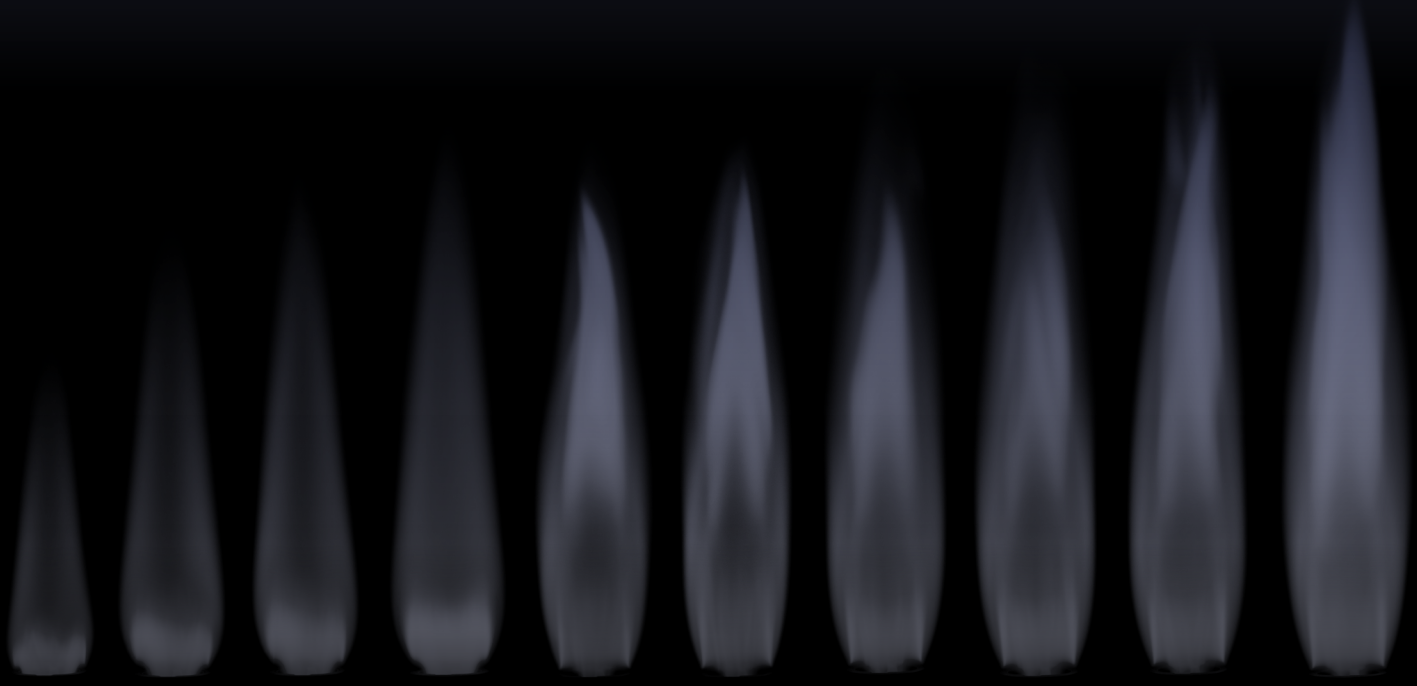
THE BIG SECRET ON WALL STREET

The LNG Giant

America's Next Great Energy Fortune Just Broke Ground



FROM THE DESK OF PORTER STANSBERRY

SPECIAL REPORT

Note: This issue of ***The Big Secret on Wall Street*** was originally published on (date). Information in this report reflects the time of publication. For the latest updates on our open positions, please visit our live portfolio link **here**.

America's Next Great Energy Fortune Just Broke Ground

Get Ready for a Crisis this Winter – It Could Make You a Fortune

Driftwood Could Turn $2 Billion into $100 Billion With Two Permits and Bechtel. When Political Delusions Run Headlong into Economic Realities...

Sunday, September 7, 2008, was a bad day for Hank Paulson.

The U.S. Treasury Secretary (and former CEO of Goldman Sachs) was dealing with a financial Armageddon – one he'd lied about.

In 2005 and 2006, Wall Street's leading investment banks (notably Merrill Lynch, Lehman Brothers, Bear Stearns, and Goldman Sachs) made a fortune by packaging thousands of individual mortgages into securities they could trade. The fees for creating these collateralized debt obligations ("CDOs") were typically around 2% of the total issuance. In 2005, Wall Street firms packaged $178 billion worth of mortgages into CDOs.

The banks were making so much money from mortgages that they began buying entire mortgage underwriting firms to gain more control over the supply of mortgages. But even that couldn't satisfy the market's demand for CDOs.

In 2006, total Wall Street mortgage-related CDO issuance was a staggering $316 billion!

Innovations and "big ideas" in the financial markets tend to follow an arc that repeats time and time again. At first, the new innovation provides clear benefits for both customers and bankers. That leads to widespread acceptance and growth in

the new financial product or strategy.

That's what happened with mortgage securities, too. Thirty years ago, Salomon Brothers began packaging prime mortgages into securities to sell to local banks across the country. It was a good way for local banks to diversify their portfolios and make their assets safer.

The growth of the new "thing" leads competitors to pile on. Every bank on Wall Street eventually creates copycat products that lead to more and more bankers chasing the same customers, and more and more customers chasing the same kinds of investments. Sooner or later, whatever advantages the early investors earned disappear as prices and fees keep increasing because of growth in demand.

That's when what was at first a good idea becomes a farce. In mortgage securities, the farce began in 2005 when Merrill Lynch stormed into the business. Merrill, whose core business was retail brokerage, was hardly an investment bank. It had zero expertise in mortgages or creating derivatives. But a complete lack of experience didn't stop it: In a span of 24 months, it made 12 major acquisitions related to the mortgage industry, including the $1.6 billion purchase of First Franklin, a major subprime mortgage lender.

And that's when things really got weird.

The banks soon discovered it was cheaper, faster, and far more profitable not to bother with underwriting or purchasing mortgages at all. Demand for CDOs was so strong that investors were willing to invest in insuring existing CDOs – securities Wall Street had already packaged. Investors were willing to make these very risky bets because for more than 50 years, real estate values had only risen. Thus, in the eyes of many investors, mortgage securities were a de facto risk-free asset. Investors were seeking more risk in housing – not less.

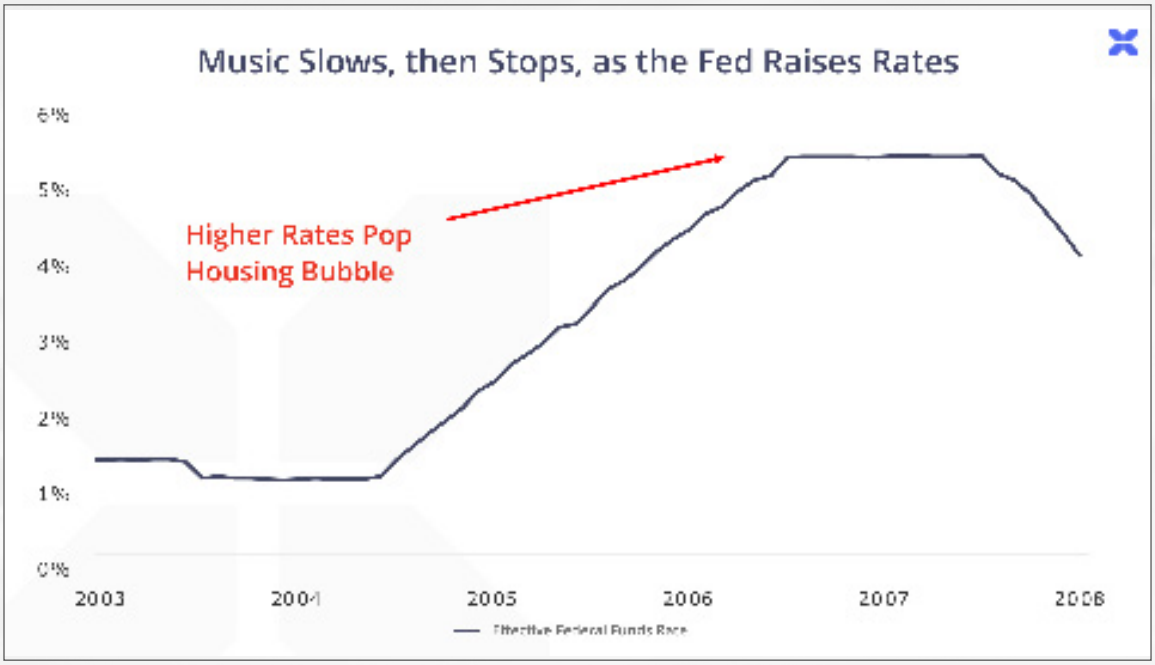
Wall Street obliged by creating "synthetic" CDOs. These were insurance contracts (what Wall Street calls "credit default swaps") that guaranteed the performance of the underlying mortgages in CDOs. These securities allowed investors to invest in specific levels (or "tranches" in mortgage risk parlance).

They allowed Wall Street to sell investors the same piece of mortgage paper multiple times, which seemed like nirvana to the bankers. And in the very short term, it did create a lot of profits and bonuses. But it also magnified and concentrated the financial risks of the mortgage security business enormously.

Finally, in the final phase of this classic Wall Street drama, everything starts to fall apart. What was a farce becomes a fraud as everyone tries to avoid holding the bag.

In the background of the mortgage/real estate mania, the Federal Reserve had

been gradually raising interest rates since 2004. By 2007, interest rates were 5.25%. That's when the music stopped.



Mortgage default rates began moving higher, faster than anyone had ever seen before. And the value of Wall Street's CDOs collapsed in turn, starting with the riskiest tranches. In the summer of 2007, the entire subprime mortgage industry imploded. Wall Street's losses quickly mounted. Quarter after quarter, the markdowns and write-offs grew and grew. Soon, the losses were in the billions.

Bear Stearns was the first to collapse in the spring of 2008.

The big problem on Wall Street wasn't really the CDOs they had already packaged. The big problem was, given the collapse in the value of existing CDOs, there wasn't any practical way for the major investment banks to sell the billions in subprime mortgages they owned in their "warehouses" – mortgages they were in the process of packaging in securities.

Nobody would buy CDOs anymore. Making matters worse, the banks also retained billions' worth of the "super senior" tranches of the synthetic CDOs they built. (Notably, these were also the securities that doomed AIG.) These were AAA-rated securities that were backed by the underlying value of millions of prime mortgages. The rating implied that there was virtually zero risk of default, which meant regulators didn't require much underlying collateral against these assets. And that meant the banks (and AIG) could hold virtually unlimited quantities of them, without any underlying collateral.

But, as the prices for CDOs worsened each week, and as mortgage default rates continued to increase, many of the "super senior" securities suffered ratings downgrades, which meant banks had to post collateral. And, as the banks were highly leveraged (in some cases 50-to-1), the amount of collateral required was gigantic. By July 2008, Merrill had written off an incredible $46 billion in mortgages and was trying to raise $8.5 billion in new stock to post as collateral.

But Treasury Secretary Paulson's real problem was Fannie Mae and Freddie Mac.

These were the two enormous government-sponsored enterprises ("GSEs") that sat at the very center of the mortgage industry. On a combined basis, these two firms provided more liquidity to the U.S. mortgage market than any other firms, by a wide margin. They owned or guaranteed almost $5 trillion worth of mortgages (roughly half of every mortgage in the country) – and were leveraged 68-to-1.

In May 2008, a well-known (loud, throat-clearing sound here) financial writer from Baltimore told people the truth about the unfolding debacle at the GSEs:

> *Freddie and Fannie own or guarantee 45% of all of the mortgages in the United States – $4.8 trillion worth of mortgages. But looking only at the mortgages they actually own and hold on their balance sheets, you find mortgages with a face value of $1.7 trillion. They hold these assets with only a sliver of equity, about $70 billion in "core" capital. On a combined basis, they're leveraged by a little more than 24-to-1. Thus, a 5% loss in the value of their mortgages would wipe out 100% of the equity in each firm. Looking beyond their balance sheets to their off-balance-sheet guarantees, you see that they're actually leveraged 68-to-1, meaning a 1.4% decline in the value of their total on- and off-balance-sheet would wipe out shareholders.*
>
> *Nationally, the average price of a home has now fallen by more than 15%. The delinquency rate for all residential mortgages at the end of the first quarter of 2008 was 6.35% – a record high. In addition, the percentage of mortgages in foreclosure is now 2.47%, up almost 100% from last year. Adding the two numbers together, you see that nearly 9% of all of the mortgages in the United States are either in default or in foreclosure. The Census*

> *Bureau reports that about 10% of houses built after 2000 stand vacant. This is unprecedented.*
>
> *Fannie Mae and Freddie Mac, the two largest and most leveraged owners of U.S. mortgages are sure to go bankrupt in the next 12 months. Congress may decide to assume their liabilities, to prevent an unprecedented global financial calamity, but Congress won't bail out the firms' shareholders. Fannie Mae and Freddie Mac are going to zero."*

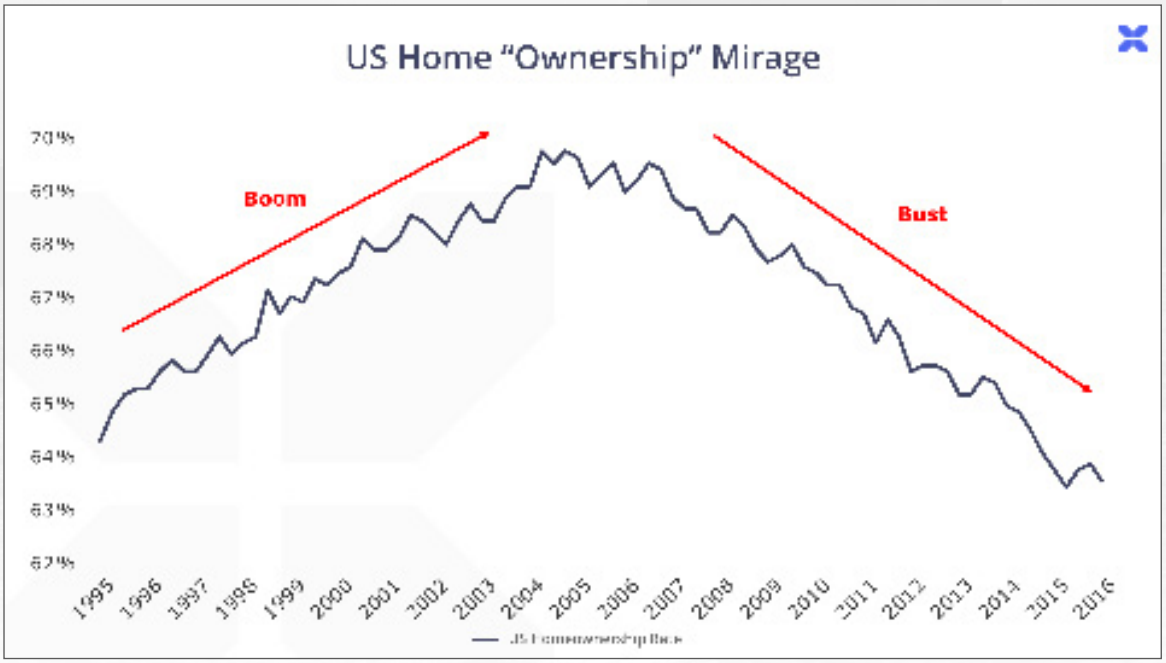
Porter Stansberry's Investment Advisory, May 2008

Government officials were not nearly as forthcoming.

On July 15, 2008, Paulson publicly brushed aside the notion that the giant GSEs at the center of America's banking system were in trouble. Fannie and Freddie are "well-capitalized," he told the Senate Banking Committee. It was a bold-faced lie.

Six days later, while meeting with a dozen large hedge fund managers (most of whom were ex-Goldman executives) at the offices of Eton Park Capital in New York, Paulson told a different story. The Treasury planned to seize the businesses, which would wipe out the shareholders.

The financial losses suffered by Fannie and Freddie totaled an incredible $265 billion. The political delusion that every American could afford a home met the cold, hard reality that surprisingly few Americans are credit-worthy enough to borrow large sums of money against fixed assets. Homeownership for millions was just a financial illusion: They were living in a credit bubble, not a house.



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Fannie and Freddie created the bubble. Now, they were bankrupt almost 4 times over. Paulson knew millions of people were about to lose their homes. And on Sunday, September 7, Paulson announced that both Fannie and Freddie were insolvent and would become wards of the Treasury – a "conservatorship."

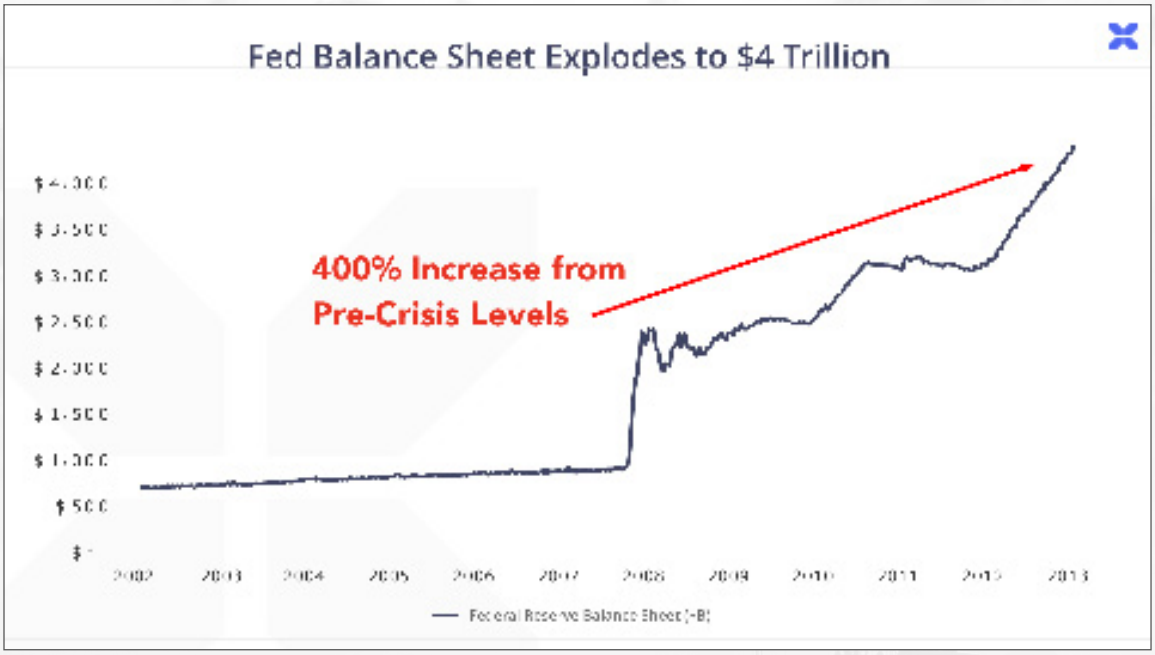
Without Fannie and Freddie, there was no functional market for mortgages. A week later, on Monday, September 15, Lehman Brothers failed and declared a $600 billion bankruptcy. Lehman's bankruptcy was an order of magnitude – 10 times – larger than the previous biggest bankruptcy in U.S. history, Enron's collapse in 2001. Lehman's losses were staggering. In the first two days of Lehman's bankruptcy, JPMorgan, backed with guarantees against losses by the Federal Reserve, had to provide Lehman with $138 billion in funding.

The next week, Merrill Lynch failed. It technically avoided bankruptcy by way of a Federal Reserve-arranged sale to Bank of America. Again, the losses were hard to comprehend. The portion of Merrill's $260 billion (!) CDO inventory that could be sold went for just 22 cents on the dollar. Shareholders at Bank of America only approved the merger because Merrill's losses were fraudulently withheld from the public. When the true extent of the losses was revealed, Bank of America's market capitalization fell by half – $50 billion – in just four trading days.

Following Lehman's collapse, the Federal Reserve would go on to offer $7.7 trillion worth of loan guarantees and swaps with financial institutions around the world. Without trillions in government financial guarantees to stem the panic and cover the losses, most of the world's major investment banks would've failed. The resulting cascade of losses would've immediately destroyed major U.S. companies, like General

Electric, which was completely reliant on Wall Street's short-term money market. So... where did all the money come from? The Federal Reserve printed it, of course.

The Federal Reserve's balance sheet immediately doubled, from less than $1 trillion to more than $2 trillion. An entire smorgasbord of new financial programs, with ridiculous names and acronyms, like TARP, sprang to life. The Fed bought billions of mortgages to bail out the banks. Later, as the government ran massive deficits to spare the economy a cleansing recession, it bought trillions in federal debt.



By the end of 2013, the Federal Reserve balance sheet rested at $4 trillion – a four-fold increase to our monetary base from pre-crisis levels.

Snowflake Economics

Believe it or not, this report isn't about mortgages or investment banking... or even specifically about corrupt government officials. *This is about what happens when politics collide with hard economic realities.*

The mortgage debacle is a perfect case study.

So, who's responsible for the mortgage crisis and the trillions of losses investors suffered because of widespread mortgage fraud?

Fannie and Freddie were by far the largest providers of capital to the mortgage market. Their guarantees created the market. In fact, without the financing they provided to the system, the 30-year fixed-rate mortgage wouldn't exist.

Why not? Because it's far too risky to offer such long-term financing at fixed rates in a government-controlled fiat currency.

Their dominance in providing capital meant their underwriting standards were the industry's standards. Fannie and Freddie dictated who could get a mortgage in the U.S. and under what terms. While this power wasn't explicitly granted to them, if your mortgage didn't conform to their standards, it couldn't be packaged and sold to them, which meant, it wouldn't be underwritten by most mortgage banks.

The problem was, Fannie and Freddie weren't rational economic actors. Even though they had shareholders, they were primarily instruments of government policy. Fannie and Freddie, much like Medicare and Social Security, offer the public the promise of enormous economic benefits, without any apparent costs.

They are, if you will, a central feature of our country's "snowflake" economic system. They offer consumers what they believe they're entitled to have – *regardless of the underlying economic reality*.

In the imaginary world of snowflake economics, Social Security isn't a tax or a liability of the federal government. It's "insurance." But, what about the trillions in unfunded liabilities of the program?

They're nowhere to be found on the government's balance sheet. They don't exist in snowflake economics. But they certainly exist in real life.

Likewise, the financial risks that Fannie and Freddie assumed on behalf of the U.S. financial system were never on the government's books. But where did the $265 billion bailout come from?

And here's what most people don't know and will never be told. The GSEs were bound to fail. They were designed to fail. There's no way they could have avoided failure – at least, not after 1992.

That year, Barney Frank, the liberal Congressman from Massachusetts and the first openly gay member of Congress (just ahead, we'll tell you why his sexuality is noteworthy) decided the government should help more Americans buy a home – even if they couldn't afford one. Frank led efforts to force Fannie and Freddie to buy mortgages held by poor people...

The Housing and Community Development Act of 1992 required the GSEs to show that 30% of the home mortgages they bought were made to people with incomes at or below the median income in their communities.

More important, the U.S. Department of Housing and Urban Development was granted the authority to adjust this regulation. Frank was determined to give mortgages to poor people, and for that power, to be a major part of the Democratic Party's economic agenda.

He didn't waste much time. In 1996, with a Democrat (Bill Clinton) in the White House running for re-election, the GSEs' median income quota was raised by 50%. Half of Fannie and Freddie's mortgage buying would be reserved to help poor people have access to mortgage credit. Then, under the George W. Bush administration, Frank was able to push it all the way to 55%.

How could any leveraged financial institution survive an underwriting policy that specifically required it to buy mortgages from mostly poor people, who inevitably had weaker credit? Maybe through massive scale? No way.

By 2002, Fannie and Freddie owned well over $1 trillion of subprime and other low-quality mortgages. The other Federal lending agencies joined the fun, too – the FHA, Federal Home Loan Banks, Veterans Administration, etc. all provided virtually unlimited mortgage financing to poor people with bad credit.

As a result, by 2008 there were 27 million subprime and other low-quality mortgages. That was half of the mortgages in the U.S. And of these low-quality mortgages, 70% were on the books of either a GSE or another government agency.

In 2003, when the bubble in mortgage finance was becoming obvious and as home prices soared, Frank was asked about the inevitable consequences of giving people mortgages they couldn't really afford. Sooner or later, there was going to be a reckoning. Frank explained,

> *I want to roll the dice a little more in this situation toward subsidized housing."*

And maybe there were other considerations, too. Fannie and Freddie weren't merely providing benefits for poor homeowners.

The growth of their portfolios made them the biggest economic engines of the D.C. swamp. They became a legal means for powerful Congressmen to enrich themselves and assure their own re-elections. In the decade leading up to the 2008 crisis, Fannie and Freddie spent a combined $170 million on direct lobbying – the biggest lobbying budget in the country.

Their executives gave another $16 million in direct political donations. They have also hired many former members of Congress and powerful Congressional staffers – Democrats, of course – giving them plush jobs with no real responsibilities. The GSEs even went so far as to open "outreach" offices in powerful Congressional districts where they served as a constant reminder to voters that it was the Democrats who got them their mortgages.

Incredibly, even after the damage caused by GSEs in the mortgage crisis, they still exist!

Of course, their liabilities are nowhere to be found in the Federal budget – it's snowflake economics, after all.

Legally, they still exist as private enterprises. But the Supreme Court ruled in the case of Collins v. Yellen in 2021 that it was perfectly legal for Congress to seize all their profits, year after year, even long after the GSEs had repaid the government for their bailout. In other words, the standing of these companies as separate from the government is entirely legal fiction.

And what is President Joe Biden's administration doing with its mortgage banks? Last September, it doubled the size of mortgages Fannie and Freddie can purchase and ordered the GSEs to implement "equitable housing finance plans."

Those plans became public recently. Fannie's plan includes efforts to encourage "sustainable homeownership for black consumers," by giving black borrowers down payments. It would also provide "loan-level price adjustments," for black home buyers.

Lenders normally require higher interest rates for borrowers with lower credit scores. Fannie plans to offset those rates to "reduce obstacles for prospective black homeowners." Its policies are specifically targeted toward black homeowners, not other minorities or low-income white borrowers.

The Constitution clearly prohibits race-based preferences in government policy... but Fannie and Freddie aren't government agencies. It's perfect snowflake economics.

Biden's administration gets to spend billions on a targeted (and heavily Democratic) special interest group, without having to go through Congress.

There's no downside – after all, these are merely loans.

The worst aspect of these policies is that the people they will hurt the most are the people the politicians claim to help. Helping someone buy a home they can't afford is an enormous mistake – even if they didn't make a down payment.

Radically increasing mortgage credit will cause a big (but temporary) increase in demand for housing. But it isn't sustainable if the homes are actually affordable. Eventually, the borrowers will default, which will set off a cascade of failed communities and lower housing prices. A lot of borrowers will get hurt.

There's no such thing as a free lunch, snowflakes.

Economic Reality in North Dakota

Fortunately for our country, something else happened on Sunday, September 7, 2008...

On the same day the housing economy collapsed, a new economy was born in America – the shale energy revolution.

At about noon that Sunday, right after Hank Paulson finished his press conference, a small independent oil and gas company, Brigham Exploration, began drilling a well in the Williston basin of North Dakota.

The well, Olson 10-15 #1H, was Bud Brigham's last chance. The looming financial crisis meant there would be no more investors to back his attempts to wrestle oil and gas out of the super hard rock of the Bakken shale. His company was $300 million in debt. And his firm's share price was collapsing. The stock, in total, was only worth $60 million.

Bud couldn't blame investors for losing faith. He'd been doing "hail Mary" fracks on his wells. There's a reason they were called a "hail Mary": they didn't work very often.

Pushing huge volumes of fracking fluid into long horizontal wells was a longshot play. The extreme distance of these deep horizontal wells resulted in widely dispersed fracking pressure. In short, the technique couldn't deliver enough pounds per square foot of pressure to crack the rock around the bore hole. No cracks meant no oil and gas flowing into the well.

His existing wells in the area produced fewer than 200 barrels a day, which didn't cover the costs of operating. But with the Olson 10-15 #1 well, Bud Brigham was trying something very different – there was nothing left to lose.

Four years earlier, a remnant of Enron, an independent oil and gas company called EOG, invented something it called "swell packers." They were tough, rubbery membranes that swelled under fracking pressure, sealing off a portion of the well.

Thus, swell packers could be used to divide up a long horizontal well into several different zones, greatly increasing the effective force (pounds per square foot) of a frack job.

Bud Brigham used basic, blue-collar logic on an $8 million drilling project.

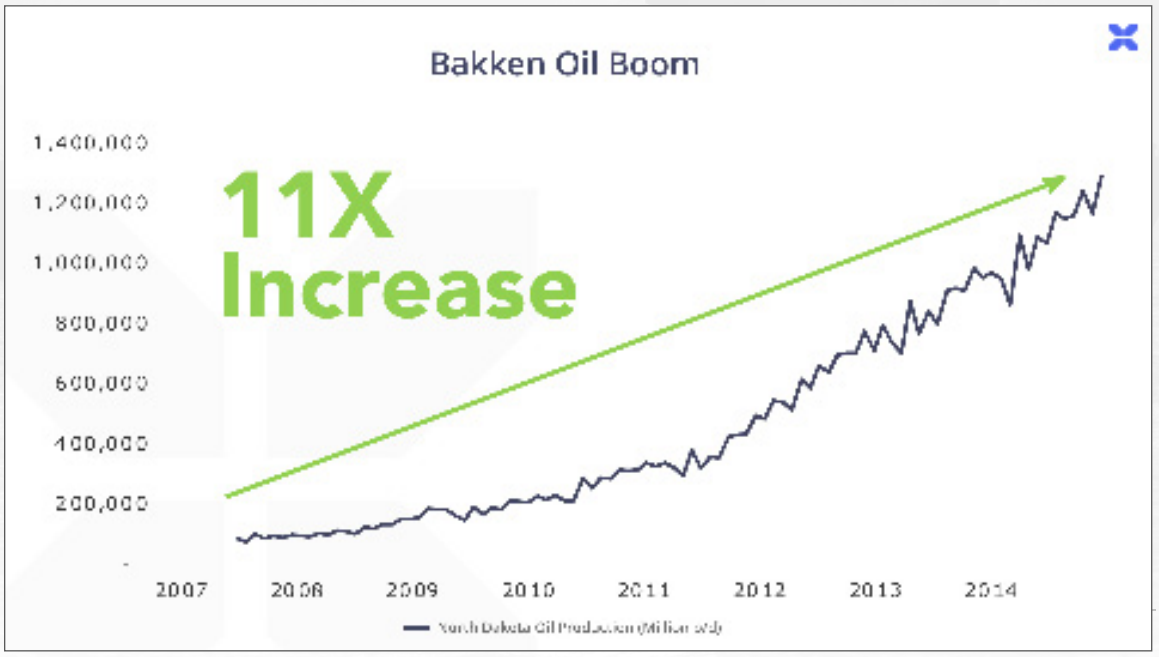
EOG had, so far, broken up mile-long laterals into five or six segments. Bud Brigham figured if you drilled a far longer lateral section and broke it up into even more segments – and fracked the hell out of it – you'd probably get a lot more oil out of the well.

So, with Olson 10-15 #1, he told his crew to drill a 10,000-foot lateral section – a horizontal well almost 2 miles long. And he told his crew to frack 20 different segments.

No one had ever done anything like that before.

Drilling the well took months – well into the North Dakota winter and at subzero temperatures. There was four feet of snow on the ground in late January after the last of the 20 frack jobs. Finally, they pulled the last tools out of the well. Would it flow...?

The Olson 10-15 #1 well produced more than 1,000 barrels of oil per day and 1.3 million cubic feet of natural gas per day. At oil prices around $100 per barrel and at gas prices around $5 a cubic foot, the Olson 10-15 #1 well was producing more than $40 million worth of oil and more than $2 million worth of natural gas a year.



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By 2011, just a little over two years after finishing the Olson 10-15 #1 well, Brigham Exploration was producing 21,000 barrels of oil equivalent per day across its 375,000 acres in the Williston basin. Brigham expected production to grow by 100,000 barrels per day. Before Brigham's Bakken breakthrough, the entire state of North Dakota produced less than 100,000 barrels of oil per day.

Brigham was also getting more efficient: It could now finish wells for only $16 in costs per barrel. By 2014, North Dakota had surpassed both California and Alaska as the No. 2 oil-producing state, behind Texas, with more than 1 million barrels a day of production. That was up an incredible 11-fold from 2007 levels...

In October 2011, Norwegian oil giant Statoil bought Brigham Exploration for $4.4 billion.

The same drilling and fracking techniques that were pioneered in the Bakken have been used across the country, nowhere with more impact than the Permian basin in West Texas. By 2014, the Permian was producing 2 million barrels a day, roughly 25% of total U.S. production.

Looking only at two layers of the Permian shale – the Spraberry and the Wolfcamp – the proven resource in the Permian is now the world's second-biggest oilfield, behind only Saudi's super-giant Ghawar. And the Spraberry/Wolfcamp isn't the only giant shale oilfield that was discovered in Texas. The Eagle Ford shale, southwest of Austin, is the fifth-largest oil reserve in the world, just ahead of Russia's largest oilfield, the Samotlor, in Western Siberia.

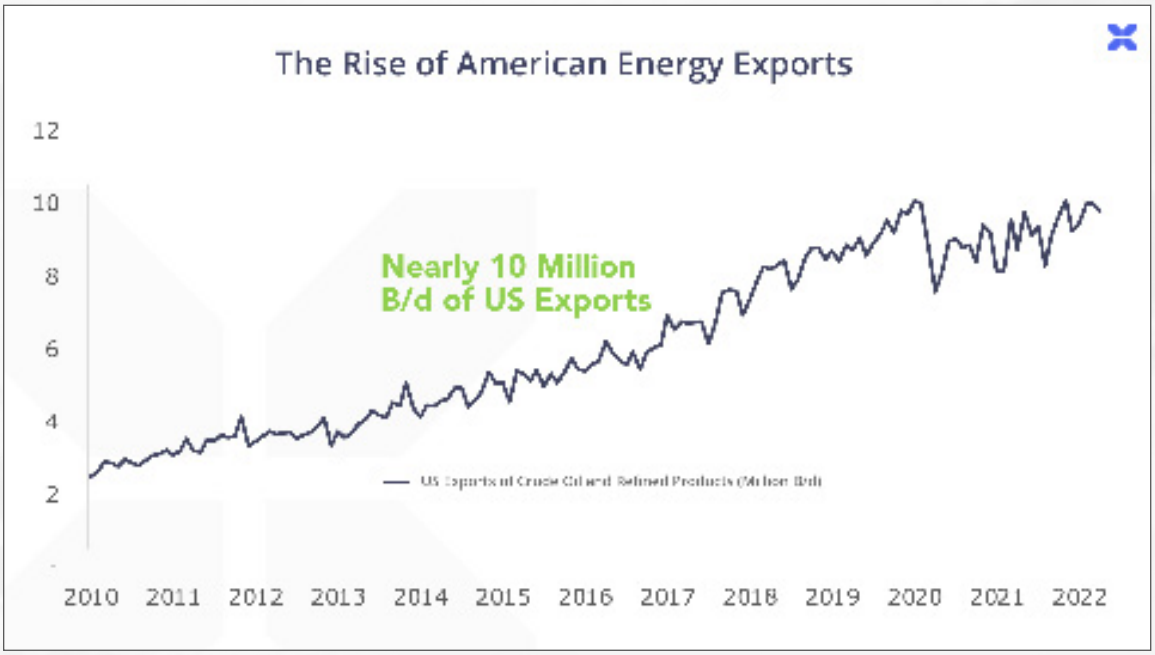
In just five years, between 2009 and 2014, Texas oil production tripled, making Texas the world's ninth-largest oil producer by itself, ahead of Mexico and Kuwait.

It's hard to exaggerate the importance of these developments to our nation's economy. And it's hard to imagine how our economy would have recovered from the mortgage crisis without it.

Beginning in 2009, net fixed investment in America's oil and gas fields has made up about 75% of all industrial investment. Increasing production of oil and gas accounts for 40% of all growth in U.S. industrial production since the end of the Great Recession. By 2019, the shale revolution directly employed 2.8 million Americans and was earning the government billions a year in licenses, fees, and taxes.

And those figures, while big, don't explain the total economic benefit.

For the first time since 1948, the United States is energy independent. We are not only the world's largest producer of oil and gas, but we are also producing far more energy than we consume, making the U.S. a net energy exporter.



In 2007, before the shale revolution, Americans sent $400 billion abroad to purchase oil, every year. Our annual energy trade gap was so big, it had become a threat to the stability of our currency.

Today, not only do we not have to spend the $400 billion every year to get the energy we need, but our oil and gas exports are growing, which improves our balance of payments.

America today exports nearly 10 million barrels per day (b/d) of crude oil and refined products – up from just 2 million (b/d) in 2010:

When Will Snowflakes Wake Up? Not Until Russian Natural Gas Is Powering Boston

> *The world is going to end in 12 years if we don't address climate change,"*

Alexandria Ocasio-Cortez says.

Before she became a Congresswoman, Ocasio-Cortez was a bartender. Clearly, she's an expert in economics – she's an avowed socialist. She believes that fossil fuels are destroying the world. What she doesn't advocate is any reasonable plan to reliably transition from today's fossil fuel-dependent economy into tomorrow's magic snowflake economy, where there's zero net emissions.

(It occurs to us that like socialists of every vintage, what Ocasio-Cortez wants is to tear down the existing power structures and replace them. Economics really has nothing to do with it. Nor does helping the poor. She just wants to be in charge.)

This isn't Venezuela – at least, not yet – so when Biden's policies abjectly fail and lead to more inflation, more bureaucracy, and lower living standards, she'll hopefully be shown the door. And that's exactly what will happen if gasoline prices keep rising or if the power grid fails... which seems more and more likely, because of the Biden administration's chokehold on America's oil and gas industry.

It would be easy to dismiss Ocasio-Cortez's fears about the world ending, except a shockingly large and growing number of powerful investors have also adopted the idea that the world will suffer catastrophic consequences if we don't completely stop putting carbon dioxide into the atmosphere.

America's largest fund managers, BlackRock and Vanguard, have joined the Net Zero Asset Managers Initiative along with almost 300 other major asset managers. Collectively, they control $61 trillion in capital – that's a huge number. Their goal is to ensure that companies have zero net emissions by 2050. All of this is, they claim, to make sure that the average temperature of the Earth doesn't rise by more than 1.5 degrees Celsius by 2100.

There are all kinds of logical problems with their premise, the first of which is simply pointing out that the Earth has been warming a long time – since at least the last Ice Age – and there's no guarantee it will stop warming regardless of whether we reduce carbon dioxide emissions. There's another logical question: Why is a slightly warmer Earth necessarily a bad thing, overall?

We agree with Warren Buffett, who responded to a proxy demand to address the risks Berkshire Hathaway faces because of climate change in his 2016 annual letter. He explained:

> *"It seems highly likely to me that climate change poses a major problem for the planet. I say 'highly likely' rather than 'certain' because I have no scientific aptitude and remember well the dire predictions of most 'experts' about Y2K."*

Outside of Berkshire's massive insurance businesses, minor changes to the weather, if they evolve over time, are meaningless from a business or investing standpoint. Insurance policies are re-priced each year. Fearing the weather in 2050 or in 2100 isn't a rational business problem, because businesses, like people, will simply adjust to the new reality, whatever happens.

Furthermore, Buffett explains that, as an insurance company, he hasn't yet seen any economic evidence to suggest that relatively small changes in the climate, even if they are occurring, have caused more severe weather, or more weather-related damages and claims:

> *"Up to now, climate change has not produced more frequent, nor more costly hurricanes nor other weather-related events covered by insurance... As a citizen, you may understandably find climate change keeping you up nights. As a homeowner in a low-lying area, you may wish to consider moving. But when you are thinking only as a shareholder of a major insurer, climate change should not be on your list of worries."*

Buffett is without a doubt the greatest investor of all time. His property and casualty insurance companies are the finest and best-run businesses in the history of the industry. And guess what? No single signatory to the Net Zero Asset Managers Initiative is as good an investor as Buffett is. Nor do any of those investors know as much as Buffett does about the potential economic risks from climate change. He owns the world's largest and best insurance companies, after all.

So, if there's no current significant business or investment risk with climate change... what's this really all about?

Net zero has become a major cudgel of the so-called "ESG" (environment, social, and governance) investment trend, which seems like an effort to starve private companies of capital unless they adhere to progressive political orthodoxy.

As a case in point, S&P Global dropped Tesla from its index of ESG companies. Has any company done more to promote the adoption of electric cars? Tesla's outspoken CEO, on the other hand, has fought back against all kinds of progressive political causes, from unions to speech codes.

Whatever you think of the legitimacy of the ESG movement, it is having a profound effect on America's most vital economic industry – oil and gas.

Suddenly, it's virtually impossible to get access to large-scale project funding to drill new oil wells. Or to build a pipeline anywhere. Or to build a new gasoline refinery. That's why production of both oil (which peaked in 2020) and gas (which peaked in 2019) is down in the United States. And that's exactly why gas prices are so high. It's not oil – there's plenty of it. It's a lack of pipelines and refinery capacity.

Currently, there's zero political will to build these energy assets – mostly because of politicians like Ocasio-Cortez and investors in the Net Zero Asset Managers

Initiative.

So… what happens when demand continues to increase, but there's little or no capital available to increase production? Prices go up. Way up.

Proving that history often rhymes, there is once again a leading, progressive politician from Massachusetts who seems determined to drive our economy off another cliff.

This time around, she's the first openly gay State Attorney general. Her name is Maura Healey. She graduated from Harvard, where she majored in government. She's been the Massachusetts Attorney General since 2015, where she's made certain no oil or gas pipelines reach New England.

Editor's Note: In this era of extreme political correctness, some here at Porter & Co. believe strongly that it is rude and uncouth to comment about someone else's sexual orientation in print. They also believe doing so will cause our enemies to paint us as bigots or at least Neanderthals.

Others of us disagree. In the first place, we're clearly not bigots, nor in any way against adult consensual sexual conduct – to the contrary, we are ardent fans. Nor do we have an iota of curiosity about what Mr. Frank or Ms. Healey do in the privacy of their bedrooms, except we have sympathy for their intimate partners. We cannot imagine what it must be like to be married to a politician.
What we do find notable, and important for investors to understand, is that they both chose to make their sexual orientation a part of their political identity, marking them as both personally progressive and politically liberal. And, in our experience, that means that they, even more than other merely liberal politicians, will be notoriously reluctant to accept economic reality.

As we've shown you, that political mindset led to catastrophe for the country's housing market in the case of Mr. Frank and, we believe, it will soon lead to a catastrophe for the people of New England.

Roughly 40% of all New England's electricity is generated using natural gas. But no new pipelines have been built in years. Healey helped ensure that the last two pipelines couldn't get permitted.

The result: New England residents pay obscenely high prices for electricity and natural gas – the highest in the nation by far. Natural gas costs almost six times more in New England than it does in most of the other parts of the U.S. And electricity costs about five times more than it does in most of the U.S.

And there's another, more serious problem. Thanks to laws regulating shipping inside

the U.S. (the Jones Act), Boston must buy the natural gas it can't get from pipelines via liquefied natural gas ("LNG") from foreign countries. That's why you have consumers in Boston, just a few hundred miles from one of the world's largest natural gas fields (the Marcellus), paying through the nose to import natural gas from Tobago.

If there's anything dumber happening in global economics right now, we haven't seen it.

That's what happens when snowflake economics hits cold, hard economic realities. And that reality is about to get a lot worse.

This year, with Russian President Vladimir Putin cutting off gas supplies to Europe, LNG is vastly more expensive than usual, with almost no LNG available on the spot market. Even worse, in September, one of the three major LNG export facilities in the U.S., Freeport LNG, suffered a fire shutting it down for the rest of the year. That's made domestic natural gas prices collapse (which has hurt our recommendation of EQT in the short term). Critically for New England, European shortages of natural gas are making the global supply of LNG extremely tight.

There's a very real chance that Boston will suffer a serious power failure this winter. They should ask Texans what that's like. Last winter, the Texas grid failed when wind turbines froze...

Ironically... the Russian LNG that has been withdrawn from the market is especially dangerous for New England. Why?

The last time New England was in a jam like this, with plummeting temperatures and zero gas in the tank, what did Healey do...? What did Ed Markey, the Massachusetts Senator who is the author of the "Green New Deal" legislation, do?

In January 2018, during a massive cold snap, New England bought a huge load of Russian LNG! The liberals from Boston bought the very first shipment of LNG from the brand-new, giant $27 billion Yamal LNG plant on the Arctic Ocean – Putin's latest energy trophy.

How does buying LNG from Russia – which presumably doesn't have any of the same environmental, social, or governance concerns that western financiers do – help save the environment?

Healey's spokeswoman explained her view:

> *"LNG is a more efficient and economical way to meet energy needs during instances of high winter demand than building high-risk and costly pipelines that are not needed to maintain reliability."*

Even the liberal Boston Globe wonders what she and the other ESG warriors are thinking. Why is building natural gas pipelines bad? Isn't natural gas a far cleaner fuel source than coal? Isn't it far safer than nuclear power? Isn't it evitable that, sooner or later, on-demand power sources must be utilized to maintain a stable power grid? And isn't it against the law to import Russian energy…?

Attention, snowflakes: The entire modern world depends on fossil fuels – some are extremely dirty. Some are relatively clean. There are 1.4 billion automobiles around the world that presently require fuel to operate. These automobiles can't be replaced overnight. And if you tried to plug them all in, there's no way the grid could supply enough power – not without fossil fuels. More than 80% of all the installed electrical generation capacity of the world operates with fossil fuels.

Without access to fossil fuels, there's no transportation. There's no electricity. There's no modern world.

How, we wonder, will the world continue to operate if there really is no more investment, at all, in fossil fuels?

David Swensen, the legendary investor, and former head of Yale University's endowment, offered this opinion about economic realities in the face of snowflake student protests at Yale:

> *"If we stopped producing fossil fuels today, we would all die. We wouldn't have food. We wouldn't have transportation. We wouldn't have air conditioning. We wouldn't have clothes."*

Perhaps Swensen exaggerates slightly. We wouldn't all die. Porter & Co. headquarters is located on a farm that's been under cultivation since 1703 – long before electricity. Not to worry, dear subscriber, we would survive.

But there are some real-life examples to consider – large economies that operate with very low levels of per capita energy consumption. Like India. If America were to meet the ambitions of the net zero crowd, our economy would have to decline in energy intensity to the level of India, where the per-capita income is about $2,000 a year. How's that sound…?

That won't happen. Not in America. So… it's only a matter of time until the political winds change. In the meantime, let's try to profit from the snowflakes' stupidity.

Less Trade, Less Investment = Much Higher Prices

Looks like we're heading into a nasty recession, one that's going to be complicated by the radical climate politics of the Biden administration and a world trade system

that's collapsing by the day.

The single most important and most valuable concept in economics is comparative advantage.

Using what your economy has in abundance, to trade for the things you don't have, makes the whole world richer. There's no "loser" in free trade. And without trade, the world economy will break down. The inflation we have seen so far will only be a prelude.

Energy prices are soaring globally because Russia has a glut of oil and gas – about 20% of the world's production. With that coming off the market because of the war in Ukraine, other producers will have to step up production significantly to fill the void – or else there will be a legitimate inflationary crisis. Likewise, the war in Ukraine has caused a huge increase in the price of food, too.

We'll see real suffering this winter in the northern hemisphere if America doesn't do more to increase energy exports. Russia has now cut its supplies of natural gas to Europe by 50%. Increases to prices mean that Russia has not lost any revenue because of these reductions to supply. That means it's almost certain further reductions will occur.

If Russia continues to starve Europe of gas, Europe will run out of natural gas before the end of the year. Even if all available U.S. LNG is shipped to Europe, it could only replace about 25% of the Russian supply. So, other suppliers, like Australia and Qatar, will have to step into the breach.

And it's unlikely enough LNG can be sourced from the world market without very significant increases to prices. The result is going to be destabilizing rates of inflation across Europe and potentially severe electrical shortages this winter.

America must respond to these challenges with our relative comparative advantages in both energy and agriculture. Our energy complex should have been mobilized already to dramatically increase production, helping to reduce the prices and provide energy security for our allies.

Vast new LNG export capabilities should already be under construction. We aren't doing these things because the Biden administration doesn't want to be seen making any new investments in fossil fuels – that's anathema to progressives.

What will Biden do? It's scary to think about.

What's most likely is short-term measures to reduce domestic energy and food prices by prohibiting exports. Yes, by separating our resources from the world's markets, we can temporarily create a glut here and lower prices. But that benefit will be temporary and the consequences for our ability to buy goods that are scarce here but in abundance in other markets will cause the overall rate of

inflation to increase and the overall value of the dollar to fall. It would also be an enormous failure on the part of America's efforts to become a global energy giant.

Given the snowflake economics of our current president, we are not optimistic about the short term. But we also expect the Democrats to be destroyed in the midterm elections. And that, along with persistent inflation and a recession, might be enough to make Biden reconsider his steadfast opposition to fossil fuel investment and infrastructure. And if it doesn't, then it's more and more likely that we'll be rewarded for our investment into America's shale revolution, not through global expansion, but simply because further restrictions to production will cause domestic prices to rise.

Either way, over the next seven to 10 years, we continue to believe the development of America's natural gas resources and our global LNG export capability are among the best investment opportunities in the world.

We expect to see several decades of growth in production and a massive expansion of global LNG revenues. Virtually nothing could be better for America's economic well-being than to continue to lead the world in producing natural gas and exporting LNG.

Talk about comparative advantage: No other country comes close to the U.S. in the size of resources or infrastructure.

There's no other practical way to ensure the reliability and the growth of the world's electrical grids other than a massive expansion of LNG and natural gas production – both of which are most likely to be led by American companies. If the climate warriors really want to reduce emissions, natural gas is the only affordable and safe way to replace coal-fired plants around the world. And that, along with new technology to enable carbon capture, is the only way to possibly come close to hitting 2050's net zero targets.

Sooner or later, the radical environmentalists in government and in finance are going to have to get realistic. Americans won't put up with $5-a-gallon gasoline and power grids that fail. And they shouldn't have to.

Our focus has been trying to understand how the biggest natural gas resources in America are mostly likely to be developed and how they will eventually be sold and delivered into the world market.

Currently in the U.S., there are only eight LNG export terminals, with the newest being Venture Global's Calcasieu Pass (a 1.41 billion cubic feet per day facility). There are, however, two other new LNG plants that are approved and currently under construction. One belongs to a partnership between super-major oil company ExxonMobil and Qatar. Called Golden Pass, it's located along the Gulf Coast at Sabine Pass, Texas. It's a 2.1 billion cubic feet per day export facility.

The other new LNG plant under construction is Driftwood LNG. It's building a 4

billion cubic feet per day terminal in Calcasieu Parish, Louisiana.

And it's very interesting.

If We Could Build Any Business in the World Right Now, We'd Build This One

The closest major shale field to the export facilities on the Gulf of Mexico is called the Haynesville shale.

It's a prolific shale resource, whose growth in production is third behind the Permian and the Marcellus.

If you were going to start a natural gas export company from scratch, the first thing you would do is buy some proven assets in the Haynesville. You'd have a permanent strategic advantage – your resource would be the closest to the largest concentration of LNG infrastructure in the U.S. You could secure a few decades of supply – gas in the ground – and start selling gas while working on the permitting of your pipeline and your LNG terminal.

Then, you'd shop around for big foreign buyers of LNG and sign up long-term purchase agreements to help finance the construction of the pipeline and the LNG export terminal. You'd want reliable partners with zero human rights or financial problems. Places like Singapore or the Netherlands. Maybe a big, major U.S. oil company, too, for credibility.

Then, you'd have to spend a fortune on lawyers to get all the permits you need to build everything and get permission to export the gas. And those permits would be worth more than their weight in gold, especially during the current administration.

Finally, you'd want to partner with one of the best and most reliable construction companies in the world, like Bechtel.

Then you'd just need to round up $6 billion in equity and maybe another $10 billion in debt financing, and you'd be off to the races.

"Yeah, I Know That Property"

About 20 years ago, Porter was fishing Piñas Bay in Panama for black marlin.

He'd flown down there with one of the best contacts in the tech field – a senior researcher at Bell Labs. They were busy talking about the wreckage of the tech bust and trying to figure out if Friendster or Myspace were going to work out as investments. (For the record, Porter never did understand the social media business model until he finally saw people using Facebook in the mid-2000s.)

But something far more important happened on that fishing trip. Porter met a living legend, the Texas wildcatter, Cactus Schroeder.

It's a long story and the details aren't important, but Porter ended up spending a day fishing with Cactus. They caught 41 sailfish that day – one of his all-time best days fishing.

Cactus is about 15 years older than Porter and was just far ahead of him in life at that time to be a mentor. Porter was – and still is – fascinated with different businesses. He loves to learn about them from real operators.

Porter sat on that boat and asked Cactus the 100 dumbest questions you can imagine – everything from technical stuff (coal bed methane was a big deal back then) to how he handled his donations to various charities. Cactus never stopped smiling. Porter didn't seem to bother him in the slightest.

Cactus has been in the oil business his entire life. His dad was in the oil business, too. He knows just about everybody in the Texas oil business. And everybody likes him.

So... when we stumbled onto this new LNG project, Driftwood, we knew who to call.

You see, unlike Cheniere (which is publicly traded and owns two very big LNG export terminals on the Gulf Coast), the folks who are building Driftwood started out with a big investment in the Haynesville shale.

They're building the exact same LNG-export business we would build. Buy the gas in the ground, cheaply. Build the pipeline to get the gas to the coast. Build the LNG terminal to sell it to the world.

The best part? There's no reason for us to go to all the trouble to build this business, because they've already done all the work.

They bought 11,060 net acres in the Haynesville in Northern Louisiana, including working interests in 78 producing wells. Last year, those wells produced 39 million cubic feet of gas a day, net to the Driftwood group. Revenue was a little over $70 million last year, up about $20 million from the year before, thanks to higher gas prices. The current value of proved reserves is $364 million.

But obviously, nobody would invest in this deal yet just because of their current production and reserves. The really important things they have in place are long-term supply deals with Gunvor (Singapore), Vitol (Netherlands), and two deals with Shell.

The company also has all the permits it needs to build the entire Driftwood project – both the pipeline and the LNG facility. And, it has a deal with Bechtel to build it.

All the pieces are in place. What's missing is only the financing.

So, we called Cactus and told him what we were working on...

> *"Oh, yeah... I see," he said. "What a deal. Sounds like some pretty smart guys working on that. I wonder how they'll get the financing done with all this ESG stuff going on. Ain't nobody can get any money these days."*

> *"Well," we replied, "they have all the permits. And someone is going to have to build some LNG soon to support Europe."*

We don't know when they'll get the financing, but we're sure it'll happen eventually. What we don't know is whether the land they bought in the Haynesville is any good.

We asked Cactus if he ever drilled any wells over there:

> *"No, I've never drilled over there. That play was super-hot maybe ten years ago. Then it really cooled off when gas prices fell out of bed. And now it is super-hot again. But there's a friend of mine that I know owns a lot of dirt over there. He's drilled a bunch of wells. Lemme call him."*

The next morning, Cactus calls us and says:

> *"Man, what a small world. Guess who sold those Driftwood guys all that land? My buddy. He sold half his acreage to them to finance all the drilling he's been doing. And he found enough gas that he's about to sell out and retire."*

Driftwood has begun construction on its LNG terminal. It broke ground in March and is proceeding with Phase I of the project.

Currently, the company's balance sheet is pretty clean. Last year, it raised $100 million in equity and paid off all its existing debt. Then it issued one small piece of debt, a senior debenture with about $56 million outstanding, for working capital.

One thing to certainly be aware of, though, is the Driftwood project is extremely

risky.

There are all kinds of things that can go wrong – and this is a tiny stock. It has a market cap of just over $2 billion. Its share price is going to be extremely volatile. Moves up of 100% or more won't be unusual. And moves down of 50% of more won't be, either.

On average, the shares are 100% more volatile than the market, so please don't buy this stock if you're uncomfortable with a lot of volatility. Likewise, this is the kind of situation where if something goes wrong, you can lose all of your money.

We don't think that's going to happen, but it isn't out of the question.

The next big move for the stock will come when it announces major funding for the next phase of the project, which could be a major equity raise with a larger energy company.

Once that happens, we wouldn't be surprised to see the market cap move above $10 billion. While an announcement like that could come at any time, we would be surprised to see a deal like that develop until later in the project timeline, maybe next year or early 2024.

There are three little things we really like about this deal that most other investors wouldn't know:

1. **First, the three largest institutional investors in the company are the three leading ESG money management firms – Vanguard, Blackrock, and State Street.**

That tells us it's likely this company will be considered one of the new breeds of energy companies, like EQT, that's embraced by environmentalists because of the amount of coal-fired power plants its natural gas exports take offline.

2. **Second, one of the other major shareholders is Paulson & Co., a hedge fund we have tremendous respect for.**

John Paulson is one of the best investors of the last 30 years, and we've followed his investing for much of that time. He's been buying shares since Driftwood started construction.

3. **Finally, the thing that gives us the most confidence in the Driftwood group's ability to get the deal financed is because the ownership group is led by Charif Souki.**

Souki is also the founder of Cheniere, the $40 billion market cap LNG export firm that was the first company to build a massive LNG export facility on the Gulf coast.

We first recommended buying Cheniere over a decade ago, at prices below $10. Driftwood is Souki's second major project. We expect it to be more successful, over time, than Cheniere was.

You won't find Driftwood trading on the stock exchanges. Driftwood is just the name of the LNG terminal and pipeline project. The project is owned by Souki's holding company, Tellurian **(Nasdaq: TELL)**.

Again, please keep in mind that this stock is going to be volatile. Huge swings in the share price won't be unusual. So, buckle up, friends.

Porter Stansberry

Porter & Co.

Stevenson, MD

P.S. If you'd like to learn more about the Porter & Co. team – all of whom are real humans, and many of whom have Twitter accounts – you can get acquainted with us **here**. You can reach me (Porter) personally via:

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