The Bright Future for Natural Gas
(And How to Profit From It Right Now)
— Rodney Johnson, Editor

No one will make a movie about the natural gas industry, but they should. You can’t make this stuff up.

While on the surface energy may be a boring topic to talk about, there’s a world of crazy turns and bold gambles underneath. None are more dramatic than the story of natural gas exports.

It starts with religious persecution on the other side of the planet in 1953 and an infant named Charif Souki.

The young boy’s father, Samyr, was scared. Gamal Nasser had staged a coup d’état in their home country of Egypt the year before, and the government was clamping down on revolutionaries. As a Greek Orthodox Christian and a writer, Samyr knew he had a target on his back. Government snoops soon were censoring his writing, and worse, following him day and night.

He knew he had to leave the country, so he picked up his family and moved to Beirut, Lebanon. There, Samyr became the chief Middle East correspondent for Newsweek. His young son grew up enjoying freedom while learning about business at his father’s knee.

When he became old enough to attend college in the early 1970s, Souki followed his father’s dream to attend university in the United States. He was thrilled to find a great school in New York, but was disappointed upon arrival.

Colgate University in the small upstate town of Hamilton, at the time an all-male college, wasn’t quite the New York of his imagination. But he finished his degree, then headed south to New York City to study business at Columbia.

When he graduated, investment firms sought him out. Souki had intimate knowledge of the Middle East, spoke Arabic, and had met many of the newly-minted petro-millionaires in the region. He became the pitchman for investments. He earned handsome commissions. But he grew bored, and he wanted to make investments instead of simply offering them.

He struck out on his own, buying properties around the world,
eventually opening a restaurant called Mezzaluna in Aspen. Soon he opened another location in L.A. He befriended his staff, including a young waiter named Ron, and a regular named Nicole, along with her ex-husband… O.J. Simpson. After the Ron Goldman and Nicole Brown murders made Souki’s restaurant famous, he left the business, looking for a different type of opportunity.

He found one in the sleepy world of oil and gas. After his failed attempts at exploration and production in the 1990s, Souki determined that the U.S. would need much more gas than it could produce at a reasonable price. He envisioned a dramatic rise in prices.

Souki had never taken a geology or engineering class, but he understood financials and statistics. Along with most others in the industry, he was well aware of oil and gas trapped in rock formations. But fractured drilling appeared to have little chance of success.

He decided to pull off an unusual feat. After taking control of an inactive but publicly traded Hollywood film colorization company with no assets, Souki changed the firm’s name and began selling new shares, raising money to build a new natural gas import facility. Souki and his family moved to Houston in 1998 so he could run the company.

That’s how Cheniere Energy was born.

When Souki took over the company, the stock traded for about $3 per share. As he used his connections to line up the financing and expertise necessary to build a natural gas import facility in Sabine Pass, Louisiana, the shares jumped to $10. Things were looking up.

But just as the facility neared completion at the end of 2008, Souki and Cheniere were hit with a one-two punch. The financial crisis made investors nervous, and fracking proved effective, opening up oil and gas reserves in the U.S. that had been considered unrecoverable.

The stock fell below $3. Creditors circled. The board of directors demanded answers. With the idea of natural gas imports all but dead, they wanted to know where Souki was taking the company. He might have appeared to be out of options, but Souki had an ace in his hand. He had a natural gas facility on the Gulf Coast connected to the gas infrastructure of the energy complex. If he couldn’t import gas, maybe he could export it.

Competing energy companies scoffed at the idea of Cheniere getting government approval for such a thing, and then raising and spending billions of dollars to retrofit its facility. Then Souki did it. He obtained his permit in 2013, and Cheniere completed the facility in 2016, at which time the company started exporting natural gas from the U.S. But Souki, the pioneer of the plans, wasn’t around to celebrate. The board of directors ousted him in December 2015.

Along the way, Cheniere’s stock hit $40 in 2013 and peaked at $80 in 2014. Based on incentives, Charif Souki was the highest paid CEO in the U.S. in 2013, pulling in a cool $142 million. He didn’t leave the company empty-handed, and didn’t see a reason to leave the industry. He took a new natural gas company, Telluran, public in February 2017.

Exploding Exports

When Souki’s Sabine Pass facility partially came online in 2016, many other natural gas export facility proposals that had received permits were mothballed. Expanding oil and gas production around the world sent prices tumbling, calling the economics of new projects into question. But a few were already under construction and are coming online this year and next.

After starting up its first “train” – the unit used to cool natural gas to minus 260 degrees Fahrenheit that can handle just under one billion cubic feet of gas per day (Bcf/d) – Cheniere brought three more trains online and is working on a fifth.

When the latest one is completed, the company will be able to process 3.5 Bcf/d. Also in 2018, Freeport Liquefied Natural Gas (LNG) expects to bring online its first train, with two more to follow in six-month intervals; Cove Point in Maryland expects to have its train operational; and Elba Island LNG in Georgia also forecasts that it will have six smaller, modular trains online, with another four to follow in 2019.

Next year, Corpus Christi LNG and Cameron
LNG both expect to come online with two and three trains, respectively. As the chart below shows, all told we could be able to export almost 10 Bcf/d by the end of 2019, a dramatic increase from where we are today.

The expanding natural gas export market didn’t come without a fight. As Souki and Cheniere fought for an exporting permit from the federal government, several giants of industry, including Dow Chemical, fought back.

Along with other industrial companies, Dow uses natural gas as a feedstock in its chemical plants. The fracking boom provided the company with very cheap energy, which boosted profits. As the Cheniere application made its way through the system, Dow Chemical partnered with other large companies to ban the export of cheap natural gas. They reasoned that the resource was a national competitive advantage that helped the companies compete in the global marketplace, which in turn meant more jobs for Americans.

The story pulled at our heartstrings, but it wasn’t quite the whole picture.

A decade earlier, Dow Chemical invested in Freeport LNG, which at the time was intended as an import facility along the Texas coast, near a very large Dow Chemical plant.

Following Cheniere’s example, Freeport LNG also applied for an export permit. This put Dow in the uncomfortable position of arguing against natural gas exports publicly while also potentially benefitting if the permits were granted. Dow owned a minority stake in Freeport LNG and did not control the company, but it still made for bad optics.

In the end, Dow and its followers lost the battle, but their claims of potential harm haven’t come true.

The price of natural gas remains at about $3, even though we’re exporting more than 2 Bcf/d. The price might rise as we export more, but that will simply entice energy companies to recover more gas.

### Growing Demand for Natural Gas Around the World

If the world of energy expanded at a leisurely pace, we might have trouble selling the gas we’re producing, but thankfully that’s not the case. Energy consumption tracks GDP growth. As countries like India and China, which also happen to be the two most populous countries on the planet, post 6%+ GDP growth every year and bring more of their populations into the middle class, they also consume massive amounts of power. These markets are hungry for energy, but it comes with a cost.

China has enjoyed strong GDP growth for almost three decades, and 4,988 coal-fired electrical plants operate in the country. Those belching plants create pollution that causes breathing problems and environmental damage. India could be on the same path if the country builds coal-fired plants to quench its thirst for energy.

Given their problems with pollution and desire for a smaller carbon footprint, these countries need fuel that’s much cleaner than coal or petroleum-based products.

Renewable fuels like solar, wind, and hydro might steal the headlines, but the mainstay of cleaner energy is natural gas.

Per unit of energy, natural gas emits about half the carbon of coal. As the U.S. brought more natural gas fired electrical plants online from 2012 through 2014 and simultaneously shut down coal-fired plants, our carbon emission dropped 3.8%.

Now that exporting cheap natural gas from
the U.S. is a reality and not a pipe dream, other countries can rely more heavily on the fuel for power generation and kick coal to the curb.

Fueling growth and cutting pollution aren't the only reasons to expect more demand for U.S. gas exports.

There's also the little matter of politics.

When gas prices spiked in the middle of the 2000s, Ukraine failed to make payments for gas it imported from Russia. But Russia couldn't simply cut off Ukraine's supply, since the same pipeline that delivered gas to that Eastern European country also fed exports to countries in the European Union. In late 2008, the Russians accused Ukrainian officials of diverting gas meant for the EU countries for its own use. The Ukrainians felt they had no choice because they needed the fuel to warm their population and feed their factories.

To force the Ukrainians to comply, the Russians cut off the supply of natural gas to everyone, driving the EU countries into an energy crisis in the depths of winter.

The crisis didn't last long. Russia is dependent on energy exports, and stonewalling some of your best clients is not a great way to build future business. But the episode highlights the problem of relying too heavily on any single source of a basic commodity.

It will serve the Europeans well to diversify their natural gas sources, including U.S. exports.

**In a Gaseous State, Natural Gas is Fungible**

Oil comes in several grades, including “light sweet,” which is produced in most of the U.S., and “heavy sour,” which primarily is found in the Middle East. Refiners build their infrastructure to handle specific grades.

Natural gas doesn't have such distinctions. When natural gas is recovered, it's either dry or wet, meaning that it contains other liquid forms of gas such as propane. If the gas is wet, other gases must be removed before the dry natural gas can be delivered to customers. Natural gas companies prefer wet gas because they can sell the other gases to earn more revenue.

Once wet natural gas has been dried, it isn't distinguishable from other sources of dry natural gas, so the fuel is fungible. This quality allows customers to use natural gas from any source. But shipped natural gas adds another layer of complexity.

The U.S. exports natural gas to Canada and Mexico through pipelines that require nothing more than drying the fuel if it's wet and then sending it on its way. But as with the Cheniere story, natural gas that's transported via ships must be cooled below minus 260 Fahrenheit. Once the fuel arrives at its destination, it must be gasified before it can be transported in pipelines and used by end customers. At first that might seem like a hurdle to exporters, but the process has become a benefit.

In 2005, only 15 countries imported liquefied natural gas. Today, 39 countries accept the fuel and more than 20 countries are in varying stages of building either their first or additional LNG gasification facility.

These plants cost billions of dollars, and they must be connected to pipelines to make sense. Once a company or country has invested so heavily and put infrastructure in place, it would be very difficult to simply abandon the project. These are long-term operations that will use LNG for many years, but they can accept gas from any source, which favors low-cost providers such as U.S. frackers.

**Technology is Our Friend**

Tesla makes a couple of cool cars. I’m not including the new Model 3 because I haven’t seen enough of it to know if it qualifies as cool. But the Model S, Model X, and discontinued Roadster all fit the bill. But there simply aren't enough of them on the road to create critical mass in a movement away from gas-powered vehicles.

Tesla sold roughly 100,000 units in 2017, more than half of all electric vehicles (EVs) that hit the road in the U.S. That's a rounding error compared to the more than 17 million vehicles sold in the U.S. last year. But looking ahead, Tesla will get a lot of company in the EV market.

Almost every major auto brand has announced
plans to migrate part or even all of its fleet to EV or hybrid vehicles. Volvo will not produce gas-only cars after 2019, and Ford just dramatically increased its commitment to EVs from $4.5 billion to $11 billion.

As automakers develop better EV offerings, and batteries gain power and endurance, more buyers will be comfortable making the switch from gas to electric. And when they do, they’ll need more electricity to keep their wheels turning.

Electric vehicles consumed roughly six terawatts of energy in 2016. They are expected to consume 1,800 terawatts of energy by 2040, a 30,000% increase! Some of that demand will be met by renewable energy sources, but the sun doesn’t always shine, and the wind doesn’t always blow. Natural gas remains the best option for either a main power plant or a peak-demand plant that can come online when necessary.

This creates something of a chicken-and-egg dilemma. Who goes first? Do consumers buy EVs and then put incredible pressure on the electrical supply system? Or do carmakers and governments build out their electrical infrastructure to support the transition?

If this happens, it could entice more consumers to convert as one of their major fears – a shortage of affordable power – will have been addressed. Either way, the U.S. and every other nation will face the need for more electricity in the years to come.

Natural gas will be a key component in satisfying that demand.

A More Immediate Concern

While more EVs, expanding economies, and political concerns will drive natural gas consumption in the years ahead, there’s a more pressing concern that will push up demand over the next several weeks… and again next year at this time.

It’s not a supply disruption in a foreign land or the imminent opening of a new pipeline. In fact, it’s not man-made. It’s the weather. As we’ve seen so far this winter, it’s cold outside, and, in general, we should experience cooler winters than usual for several years. That will push natural gas consumption higher for both electricity generation and as a heating fuel.

To be clear, I’m not addressing climate change, global warming, or anything on a grand scale. I’m not saying that those trends do not exist, or that they are wrong. Harry has done a lot of work on climate, and pointed out several long-term cycles that inform his work on where we are headed over the next century, but that’s not the topic at hand.

I’m talking about something much more immediate, easily measurable, and directly related to warmth on earth: solar radiation, typically associated with sun spots.

As sun spots erupt on the surface of the sun, they create massive waves of solar radiation, some of which strike the earth. As you can see in the chart, changes in solar radiation coincide with changes in our temperature.

Using data collected from ice core samples, we know that solar radiation and temperatures correlate back more than 200,000 years. The most recent cooling period, the “mini ice age” in the 1600s, correlated with the Dalton Minimum sun spot period, when few sun spots occurred. Today we are leaving the Modern Maximum period of higher sun spot activity that peaked in the 1950s. The next several years should see minimal sun spot activity, and therefore less solar radiation, leading to lower temperatures in the winter.
As I write this, I’m looking at snow outside my window, and I live south of Houston by the Texas coast. This is the third time it has snowed in our neighborhood this winter! But I’m not bundled up in a parka, or even walking around in two pairs of socks and three sweaters.

Instead, I turned up my gas-fired heater. It might be 29 degrees outside, but it’s 69 degrees inside, and that’s before I light up my gas log fireplace.

This same scene is playing out in many places across the U.S. Overall, the winter of 2017-18 is shaping up to be colder than recent years, and there’s one source that laid out the possibility before it happened: The Farmer’s Almanac.

That venerable source of weather information uses three scientific disciplines to forecast the weather: climatology, meteorology, and solar science (the study of sun spots and other solar activity). As the Almanac’s writers note, linking sun spots and weather is somewhat controversial, but there’s no disputing the incredible correlation of sun spot activity and temperature.

As for what to expect in the weeks and months to come, the National Oceanic and Atmospheric Association (NOAA), forecasts exceptionally low sun spot activity.

The winter storm that pummeled the East Coast at the beginning of January brought the coldest New Year’s in New York in a century. U.S. demand for natural gas that day reached a record 150.7 billion cubic feet.

**We’ve Got the Resources**

In 1994, the U.S. Energy Information Administration (EIA) estimated that the country held 170 trillion cubic feet of proven natural gas reserves. By 2004, the number had jumped to 200 trillion cubic feet due to fracking.

As of 2017, the EIA estimated that we had 324 trillion cubic feet of natural gas. That amount would supply the U.S. for more than 80 years – and that’s if we don’t discover more. With so much of the fracking industry still offline after prices plummeted in 2015 and 2016, there’s little new exploration underway.

As the industry ramps back up, the estimate of proven reserves should move up with it.

**All Factors Point to a Growth Industry**

With growing domestic supply, greater uses at home due to technological advances and weather, more demand overseas, and newly developed methods for export, natural gas is poised to be a growth industry for years ahead.

Everything from exploration and production, to transport and shipping, to electric power generation and maintenance should enjoy exceptional growth and keep segments of the U.S. economy humming.

With all of this industry in motion, the natural question is, how do we make money off of it? That’s exactly what Charles addresses next.
The Best Natural Gas Investment to Make Right Now

— By Charles Sizemore, Portfolio Manager

Rodney made a strong case for natural gas.

Between export demand, a preference for clean natural gas over dirty coal to meet environmental obligations, and generally colder winters over the next couple of years, demand for natural gas should only grow.

It may be “old economy” and less sexy than solar or wind power, but it’s also far more stable and reliable. And for the foreseeable future, natural gas is going to be the energy industry’s workhorse.

Case in point: You might have seen me mention my ski trip to Colorado just after Christmas. I took the family to Breckenridge. We opted to drive from Texas rather than fly. Part of this was for economic reasons (it isn’t cheap flying a family of four during the busiest travel week of the year), but part of me thoroughly enjoys the drive.

The kids spend most of the trip playing video games or watching movies, and my wife usually dozes off for a few hours. With no real distractions, I can let my mind wander while I drive. It’s peaceful. (I also like stopping for dinner at the Big Texan Steak Ranch in Amarillo, home of the world-famous 72-ounce steak. Please don’t judge me.)

The north Texas panhandle around Amarillo is a yellow, desolate, windswept badland. When the wind really blows, tumbleweeds spin across the highway and it’s hard to stand up straight.

Not surprisingly, thousands of windmills in the area generate electricity. That part of Texas is as flat as a pancake (Harry used to joke in speeches that you can watch your dog run away from home all day), and yet the windmill farms stretch as far as you can see.

But the wind doesn’t blow all the time. And on the particular December day I happened to drive through, there was barely a breeze. The windmills stood perfectly still. That’s a problem if you depend on that wind to deliver your power.

I’m a big fan of wind energy. It’s green and it’s essentially free. But as I could see with my own eyes, it really won’t get the job done as a primary source of energy for a modern economy.

We need natural gas.

That said, investing in natural gas outright via futures contracts, ETFs or other financial products is a tough row to hoe. To start, natural gas prices are volatile. And while demand may be poised to grow, the fracking revolution virtually guarantees that we’re going to be awash in supply for a long time to come.

Consider the United States Natural Gas ETF’s (NYSEArca: UNG) performance over the past few years. Since 2014, the ETF has lost about 75% of its value… and this during a time when natural gas consumption was growing.
Buying and holding natural gas is a nonstarter. But there’s one straightforward way to profit from this macro trend, which promises to be one of the biggest investing stories of the next decade: focus on transportation, processing and logistics.

I don’t know what natural gas prices will be next year or 10 years from now. But I can say with a lot of certainty that global consumption will be higher a year from now and much higher 10 years from now.

If you’ve read Boom & Bust for a while, you might remember that we’ve delved into the master limited partnership (MLP) sector a few times, most recently with Targa Resources (NYSE: TRGP).

Midstream oil and gas MLPs own energy infrastructure, primarily pipelines, and their revenues tend to be based on the volume of oil and gas piped – which tends to be very stable – rather than its price, which can jump around all over the place.

Unfortunately, I was a little early with Targa. I recommended it in the April 2017 issue of Boom & Bust, and shortly thereafter the company diluted its shareholders by 20%, which tanked the stock price below our stop-loss level. And MLPs went on to have a lousy year in 2017, even as energy prices stabilized and volumes enjoyed nice growth.

Though it’s impossible to ever fully know “why” a sector falls out of favor, it seems that rising bond yields played a big part.

MLPs are a little like Real Estate Investment Trusts (REITs) and utilities in their sensitivities to interest rates. Because they tend to be highly leveraged, higher borrowing costs can dig into profits. But MLPs and REITs are also considered bond substitutes by a lot of investors, so rising bond yields (and falling bond prices) generally means rising MLP yields (and falling MLP prices).

Well, I don’t see this being a problem going forward for two reasons. I don’t see bond yields going much higher from here. Harry sees the 10-year yield topping out at around 3%, which isn’t much higher than today’s 2.6%.

But the bigger reason I don’t see yields being much of a problem. MLPs have sold off far more aggressively than bonds, and the spread between MLP yields and Treasury yields is now close to the widest in history at 5%. The only times in history that the spread has been wider was during the 2008 meltdown and the 2015 energy collapse.

Let’s talk more about yield.

As a sector, MLP yields have traded in a range of around 6% to 8%, and today yields are near the top of the range at 7.8%. Yields were higher in the late 1990s, when the MLP asset class was still new and unproven, and during the 2008 meltdown and the 2015-16 energy crisis. But those yields can’t be considered “normal.”

It’s amazing, but in a market that’s otherwise looking bubbly and expensive, MLPs are a value
sector trading at some of their cheapest prices in history.

This brings me to our new recommendation this month: **Williams Partners LP (NYSE: WPZ)**.

I chose Williams from a large pool of contenders for a handful of critical reasons.

First, Williams focuses almost exclusively on natural gas. Many of its competitors focus more on crude oil or have a relatively balanced portfolio. But we're specifically looking for natural gas exposure, so Williams has the advantage here. Williams has over 33,000 miles of pipelines in operation and is very well-positioned in the natural gas basins offering the best growth prospects.

Williams management is smart enough to know where its growth markets will be in the years ahead. Williams expects global demand for LNG exports to jump by 63% by 2025, and, in a recent investor presentation, Williams specifically cited the positioning of their pipelines close to LNG export terminals as one of its assets.

I agree.

Also, 97% of Williams Partners' gross margins come from fee-based sources, which protects the company from wild price swings. The price of natural gas can go up, down, or sideways, and it won't really matter much to Williams' bottom line.

One of the biggest complaints about MLPs is that unitholders lack the same basic rights that regular corporate shareholders enjoy. The most glaring example of this are the dreaded incentive distribution rights (IDRs).

In theory, IDRs are supposed to incentivize management to responsibly raise distributions for the unitholders. Management (the general partner) essentially gets a cut of any distribution hikes, and the more aggressive they are, the cut actually gets larger as a percentage of the total. Dallas and Houston are full of MLP billionaires that got rich that way.

Well, I’m happy to say that Williams got rid of its IDR structure last year. The general partner – Williams Companies (NYSE: WMB) – permanently waived its IDR rights.

It wasn't purely an altruistic move. The IDRs had become a major turn off to investors and weighed on Williams Partners' stock price. What's more, Williams Companies is the largest owner of Williams Partners, controlling more than 70% of the units outstanding. So by throwing a bone to the unitholders of Williams Partners, Williams Companies was really just helping itself.

I'm good with that. We want management's interests aligned with our own. The recent moves are a major step in that direction.

Williams Partners sports an attractive and well covered distribution of 5.6%. The company actually cut its distribution early last year, which would normally be a major red flag for me. But in Williams’ case, the distribution cut was part of the larger reorganization of the company that included the elimination of the IDR. It was a case of short-term pain in order to get long-term gain. Williams Partners expects to raise its dividend by about 7% per year over the next several years.

MLPs have historically had a very quirky business model. They would pay out almost the entirety of their free cash flow to investors as distributions and then turn to stock and bond markets to raise whatever capital they needed for growth projects.

Well, the model worked great… right until it didn't. Many MLPs, even some of the larger blue chips, found themselves effectively locked out of the capital markets back in 2015 when the energy market was going into convulsions. Many were forced to slash their distributions to conserve cash. It was an ugly experience. No one who lived through it would want to see it repeated.

Williams was never quite as cavalier with debt as some of its rivals, and today, its ratio of debt to earnings before interest, taxes, depreciation and amortization (EBITDA) sits at a healthy 3.5x, which is well below the 4.0x to 4.5x that is considered to be an industry standard.

So, even if the MLP market gets choppy again, Williams should be in a good place to ride it out.

MLPs are a cheap and beaten-down sector in an otherwise ridiculously expensive market, and I expect them to beat the pants off the market this year. And after years of underperformance, they're finally starting to rally.

So please take the following action:
Action to Take: Buy shares of Williams Partners (NYSE: WPZ) at market. Set an initial stop-loss at $28.25 based on closing prices.

At current prices and yields, I believe we can easily generate total returns of 20% per year or more over the next few years. And that’s not too shabby!

Portfolio Update

We got an important reminder this week of why we use stop-losses.

Albemarle Corp (NYSE: ALB), which has been our best-performing stock over the past year, got hit by a wave of selling that has dragged down most lithium-related stocks. It closed below our stop-loss on Thursday, so on Friday I recommended selling it.

Well, on Monday, it continued to drop, falling another 2%.

The news that started all of this seemed innocuous enough. Chilean miner Sociedad Quimica y Minera de Chile resolved an ongoing dispute with the Chilean government that allows the company to ramp up its lithium production.

All else equal, a big jump in lithium supply means lower prices and tighter margins.

Well, that might be true, but it hardly explains why Albemarle would have a drop like this. I think it’s more likely that traders simply used this as an excuse to take profits. Albemarle has had a huge run, and this was the signal for shorter-term momentum traders to jump ship.

No worries.

We walked away with a handsome 50% profit, and we can always re-enter the trade later. Virtually every major world automaker is following Tesla’s lead and shifting their focus to electric vehicles, and battery-powered smart devices proliferate more and more by the day. All of this points to greater demand for lithium, which benefits producers like Albemarle.

But, for now, Mr. Market is telling us to steer clear, so that is exactly what we’re going to do. We have plenty of other opportunities to explore in the here and now.

And speaking of those…

We’ve been busy since the last monthly issue. In case you missed the email updates, we added three new tech names to the portfolio – chipmakers Advanced Micro Devices (Nasdaq: AMD) and Nvidia (Nasdaq: NVDA) as well as Lam Research (Nasdaq: LRCX), which makes the equipment used to make computer chips. Each of these is, among other things, a play on the long-term viability of cryptocurrencies.

Now, as I write this, Bitcoin – the granddaddy of cryptos – is in a bona fide bear market, down from its recent highs by nearly half. The Bitcoin story may very well be over at this point… or this may be yet another bump in the road. It’s just too early to say.

But that’s OK. Our position on cryptos hasn’t changed since Rodney wrote about it in the December issue. Bitcoin may very well be the biggest bubble in the history of financial bubbles, and Rodney recommended steering clear of it. But the bigger story – that of the blockchain distributed ledger and philosophical ideas that support Bitcoin – is valid.

Bitcoin’s ultimate flaw – and the reason it can never be a true currency – is that its supply is capped at 21 million coins. That scarcity is one of the reasons bulls use to justify its price, but it also all but guarantees that Bitcoin will fail as an actual currency. The scarcity incentivizes people to hoard it rather than use it for day to day spending.

Furthermore, the maintenance of the blockchain that underpins Bitcoin (and all cryptocurrencies)
requires miners. But why would anyone volunteer their computer’s resources to supporting the blockchain if they no longer got rewarded with freshly-mined coins?

All of this suggests that Bitcoin will ultimately fail. But the ideas that made it popular to begin with – an anonymous currency that exists outside the traditional banking system that is immune to government meddling and central bank interventions – are as strong as ever. And companies are finding new applications for cryptos every day.

IBM – yes, boring, stodgy, and clueless IBM – is actually at the forefront of the innovation, and their cryptocurrency solution – the lumen – is already being used to facilitate cross-border trade in parts of southeast Asia and elsewhere. Poor farmers that might normally be locked out of the formal financial system (or be forced to pay punitively high fees) can now sell their produce to buyers in neighboring countries using the lumen as a medium of exchange between two or more national currencies.

And this is just the beginning. Just as the early internet era of the 1990s had a colossal shakeout in 2000 that saw the weaker players die and the stronger players grow into the dominant internet names we know today, you’re going to see a similar shakeout in blockchain and cryptocurrency technologies. It may very well already be underway.

But whichever coins and technologies end up winning, there is likely to be a lot of mining going on. That means continued high demand for our recent additions.

On a side note, Lam Research was featured in this past weekend’s Barron’s Magazine. Barron’s does an annual roundtable in which it gets the best investment ideas from a group of prominent money managers. Jeff Gundlach – who managed the DoubleLine Income Solutions Fund (NYSE: DSL) in our portfolio – is a fixture in roundtable, as are Mario Gabelli, Abbey Joseph Cohen and a host of other high-profile names.

Scott Black, founder of Delphi Management, had this to say:

*We like companies that generate a good return on equity and free cash, and we like to buy them at low absolute multiples. My first pick is Lam Research. It is a powerhouse in semiconductor capital equipment…*

Lam has $22 a share in net cash. Exclude that and the stock sells for 11.6 times earnings. It is a giveaway. The average company sells for 19 times earnings, and LAM isn’t an average company.

*Return on book value could top 30% in calendar 2018. Free cash is equal to net income... Lam has the wind at its back. It generates 86% of its revenue in Asia, and its chief customers include Micron Technology, Samsung Electronics and Taiwan Semiconductor Manufacturing.*

Scott Black is a heavy hitter, and I was happy to see that we’re fishing in the same pond. But just remember… you heard it here first!

Moving on, Harry called it when he said in the November issue that the next big bull market will be in commodities… though that bull market seems to be picking up steam faster than expected. Our Brazilian miner Vale (NYSE: VALE) is up a whopping 35% and is now the best-performing stock in the portfolio.

Vale is a wildly volatile stock, and it’s one that we have to give a relatively long leash. But given the recent run, I do want to raise our stop.

**Action to Take: Raise your stop-loss in Vale (NYSE: VALE) to $10.00 based on closing prices.**

Home Depot (NYSE: HD) isn’t too far behind, however. We’re up 29% in a little over four months. Not too shabby!

Let’s be smart and lock in some of those gains.

**Action to Take: Raise your stop-loss in Home Depot (NYSE: HD) to $177.00 based on closing prices.**

I’m also going to recommend we raise our stop in Indian auto giant Tata Motors (NYSE: TTM). We’re up a modest 8%, and I expect more gains to come if emerging markets continue to lead. But it also makes sense to take profits along the way.

**Action to Take: Raise your stop-loss in Tata Motors (NYSE: TTM) to $26.00 based on closing prices.**

Alas, it’s not all sunshine and roses. Our bullish play on the dollar (and bearish play on the euro) from last month’s issue – the ProShares UltraShort Euro
ETF (EUO) – is off to a slow start, down about 5%.

I recommend you keep the faith here. While the recent government shutdown and the political shenanigans in Washington might cause you to question your confidence in the greenback, the trends that really matter still favor it. Interest rates are higher in the United States (even while inflation remains low), and money tends to go where it’s treated best. I expect the dollar to leave the euro in the dust in 2018.

But if I’m wrong – and currencies often seem to have a mind of their own – no worries. We’ll simply follow our stop loss guidance and move on.

That’s going to wrap it up for this month.

**Boom & Bust Portfolio**

<table>
<thead>
<tr>
<th>Investment</th>
<th>Ticker</th>
<th>Entry</th>
<th>Added</th>
<th>Buy Price</th>
<th>Current Price</th>
<th>Stop Loss</th>
<th>Total Dividends</th>
<th>Total Returns</th>
<th>Call</th>
</tr>
</thead>
<tbody>
<tr>
<td>Williams Partners</td>
<td>WPZ/NYSE</td>
<td>NEW</td>
<td></td>
<td>$188.83</td>
<td>$215.07</td>
<td>$173.00</td>
<td>$0.00</td>
<td>13.90%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Lam Research Corporation</td>
<td>LRCX/NYSE</td>
<td>1/11/18</td>
<td></td>
<td>$12.82</td>
<td>$12.65</td>
<td>$8.70</td>
<td>$0.00</td>
<td>5.73%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Nvidia</td>
<td>NVDA/NYSE</td>
<td>1/11/18</td>
<td></td>
<td>$224.35</td>
<td>$233.69</td>
<td>$175.00</td>
<td>$0.00</td>
<td>4.16%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Advanced Micro Devices</td>
<td>AMD/NYSE</td>
<td>1/8/18</td>
<td></td>
<td>$9.82</td>
<td>$13.32</td>
<td>$10.00</td>
<td>$0.00</td>
<td>35.64%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Vale S.A.</td>
<td>VALE/NYSE</td>
<td>10/30/17</td>
<td></td>
<td>$46.82</td>
<td>$51.00</td>
<td></td>
<td>$40.00</td>
<td>10.87%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Targa Resources</td>
<td>TRGP/NYSE</td>
<td>9/21/17</td>
<td></td>
<td>$159.66</td>
<td>$204.46</td>
<td></td>
<td>$177.00</td>
<td>28.62%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Home Depot</td>
<td>HD/NYSE</td>
<td>9/8/17</td>
<td></td>
<td>$159.66</td>
<td>$204.46</td>
<td></td>
<td>$177.00</td>
<td>28.62%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Tata Motors Limited</td>
<td>TTM/NYSE</td>
<td>9/1/17</td>
<td></td>
<td>$30.54</td>
<td>$32.88</td>
<td>$26.00</td>
<td>$0.00</td>
<td>7.66%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Novartis AG</td>
<td>NVS/NYSE</td>
<td>7/26/17</td>
<td></td>
<td>$84.85</td>
<td>$87.00</td>
<td>$73.40</td>
<td>$0.00</td>
<td>2.53%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Scotts Miracle-Gro</td>
<td>SMG/NYSE</td>
<td>5/25/17</td>
<td></td>
<td>$88.83</td>
<td>$106.93</td>
<td>$93.00</td>
<td>$1.06</td>
<td>21.57%</td>
<td>Buy up to $100</td>
</tr>
<tr>
<td>Fomento Economico Mexicano</td>
<td>FMX/NYSE</td>
<td>3/2/17</td>
<td></td>
<td>$82.15</td>
<td>$96.04</td>
<td>$85.00</td>
<td>$1.35</td>
<td>18.55%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>DoubleLine Income Solutions Fund</td>
<td>DSL/NYSE</td>
<td>1/26/17</td>
<td></td>
<td>$19.51</td>
<td>$20.19</td>
<td></td>
<td>$19.50</td>
<td>13.69%</td>
<td>Hold</td>
</tr>
</tbody>
</table>

**BUST PORTFOLIO**

<table>
<thead>
<tr>
<th>Investment</th>
<th>Ticker</th>
<th>Entry</th>
<th>Added</th>
<th>Buy Price</th>
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<th>Stop Loss</th>
<th>Total Dividends</th>
<th>Total Returns</th>
<th>Call</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proshares UltraShort Euro ETF</td>
<td>EUO/NYSEArca</td>
<td>12/29/17</td>
<td></td>
<td>$21.20</td>
<td>$20.22</td>
<td>$18.40</td>
<td>$0.00</td>
<td>-4.62%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>Nuveen Quality Muni Income Fund</td>
<td>NAD/NYSE</td>
<td>12/27/16</td>
<td></td>
<td>$13.72</td>
<td>$13.69</td>
<td>$12.15</td>
<td>$0.82</td>
<td>5.76%</td>
<td>Buy - At Market</td>
</tr>
<tr>
<td>BlackRock Municipal 2030 Target Term Trust</td>
<td>BTT/NYSE</td>
<td>9/27/16</td>
<td></td>
<td>$24.11</td>
<td>$20.22</td>
<td></td>
<td>$1.22</td>
<td>-3.47%</td>
<td>Buy - up to $24.50</td>
</tr>
</tbody>
</table>

**NOTES:** The Boom & Bust Portfolio is an equally-weighted strategy and does not include dealing charges to purchase or sell securities, if any. Taxes are not included in total return calculations. “Total return” includes gains from price appreciation, dividend payments, interest payments, and stock splits. Securities listed on non-U.S. exchanges; total return also includes any change in the value of the underlying currency versus the U.S. dollar. For transparency sake, we want you to know that we have an advertising relationship with EverBank. As such, we may receive fees if you choose to invest in their products. Stop-losses: The Boom & Bust Portfolio maintains stop-losses on every stock, ETF and bond recommendation; stop-losses are not exercised for mutual funds unless otherwise noted. Sources for price data: Yahoo! Finance (finance.yahoo.com), Financial Times Portfolio Service (www.ft.com), TradeNet (www.trade-net.ch/EN), and websites maintained by securities issuers.

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