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OIL VS GOLD:

- An Evaluation of Peak Oil Theory and Investment Perspectives on Oil vs Gold

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Understanding free market economics leads to exceptional investment success.



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Ron Holland is a long-time advisor to international investors seeking secure, legally compliant strategies to protect and grow wealth. He currently serves on the Board of Advisors of a major Swiss wealth management firm and is co-editor of the successful financial report Mountain Vision.

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A White Paper on Oil versus Gold

- **An analysis of the investment potential of oil versus gold**

Introduction

Is oil as good an investment as gold? There have been many who have argued in recent decades that the West is verging on an energy scarcity known in aggregate as "Peak Oil" and that with oil running out, there is nothing much better in the world to own than black gold.

Peak Oil proponents believe the world is running out of oil because the available supplies have been depleted and what is left is very difficult to extract. This has proven to be a popular concept for numerous reasons, and there are many web sites devoted to Peak Oil. But is oil really as good an investment as gold, or even silver? The purpose of this White Paper is to answer that question.

Gold and silver are money metals that have held their value for thousands of years. Oil is a commodity that has been increasingly valuable for about a century. But beyond the time difference, there are other questions that one must evaluate before making the decision as to whether oil is as valuable (or even more so) than gold or silver from an investment standpoint today.

The main question about the value of oil comes down to whether or not oil is really in short supply. This White Paper will examine the validity of Peak Oil and present the arguments, below, of proponents of the concept. The White Paper will then present the arguments of anti-Peak Oilers.

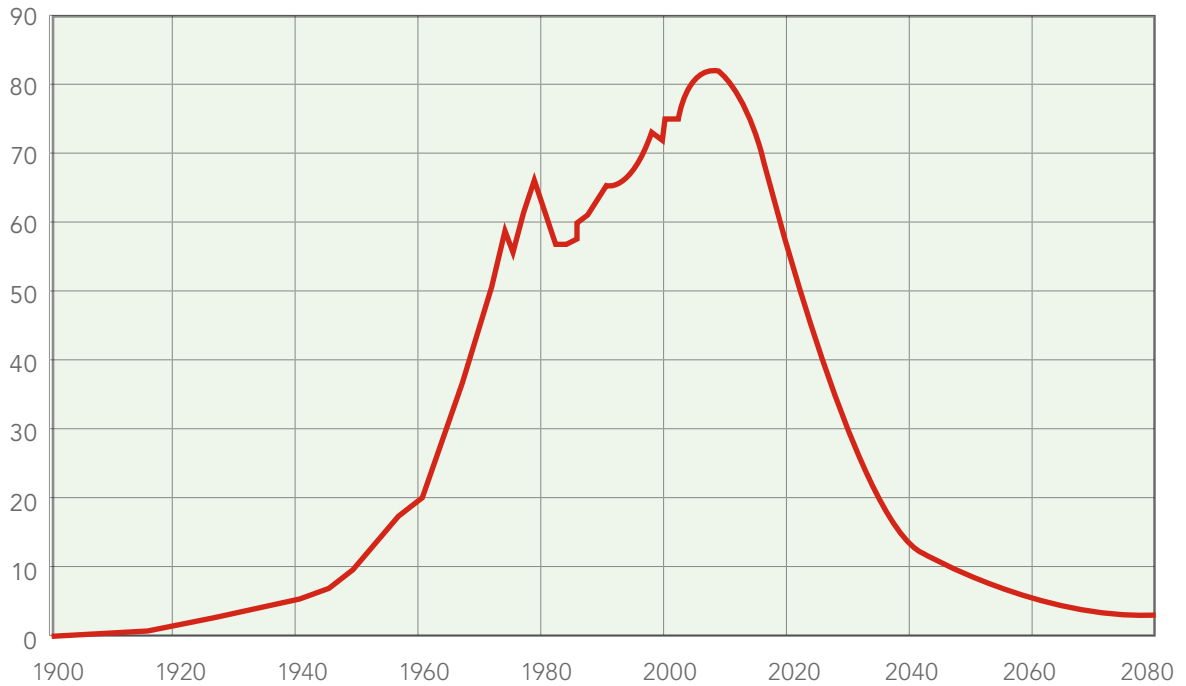
Finally, this White Paper will compare and contrast the value of gold and silver to oil and oil byproducts. A conclusion will summarize the arguments inherent in the Peak Oil point of view and also those that propose that gold, and silver remain a better store of value.

Peak Oil: An Evaluation

In order to evaluate the validity of oil as an investment, it is necessary to understand the validity of Peak Oil arguments. A comprehensive website by Matt Savinar. "Life After the Oil Crash" makes arguments that are common among such sites. In an open letter at the front of the website, he writes that,

"Civilization as we know it is coming to an end soon. This is not the wacky proclamation of a doomsday cult, apocalypse bible prophecy sect, or conspiracy theory society. Rather, it is the scientific conclusion of the best paid, most widely-respected geologists, physicists, bankers, and investors in the world. These are rational, professional, conservative individuals who are absolutely terrified by a phenomenon known as global 'Peak Oil.'

World Oil Production 1900-2080



Savinar, who sells disaster equipment and foodstuffs on his site advises reader that "Oil will not just 'run out,' but that "oil production follows a bell curve." (See above.) He then expands on his thesis with the following points:

This is true whether we're talking about an individual field, a country, or on the planet as a whole. Oil is increasingly plentiful on the upslope of the bell curve, increasingly scarce and expensive on the down slope. The peak of the curve coincides with the point at which the endowment of oil has been 50 percent depleted. Once the peak is passed, oil production begins to go down while cost begins to go up.

In practical and considerably oversimplified terms, this means that if 2005 was the year of global Peak Oil, worldwide oil production in the year 2030 will be the same as it was in 1980. However, the world's population in 2030 will be both much larger (approximately twice) and much more industrialized (oil- dependent) than it was in 1980. Consequently, worldwide demand for oil will outpace worldwide production of oil by a significant margin. As a result, the price will skyrocket, oil dependant economies will crumble, and resource wars will explode.

Peak Oil is also called "Hubbert's Peak," named for the Shell geologist Dr. Marion King Hubbert. In 1956, Hubbert accurately predicted that US domestic oil production would peak in 1970. He also predicted global production would peak around the year 2000, which it would have had the politically created oil shocks of the 1970s not delayed it for about 5-10 years.

It all sounds very logical, and if one accepts these arguments, then there may be nothing in the world more attractive than an investment in oil, either at the source or through one of the majors on a bourse. However, like most things in life, there are two sides to every story. In "Peak Oil Debunked," we learn from an "ex-Peak-Oil Doomster" that maybe things aren't so grim after all.

The self-styled redeemed Peak Oil-Doomster goes by the blog-name of Dr. Doom. He admits that he was a long-term Peak-Oil enthusiast, and that he was in fact converted to the cause by Savinar (quoted above) whose site he read at length. Thus, Dr. Doom's eventual epiphany (comprehension of the other side of the story) may be seen as a direct rebuttal of Savinar.

In an introduction to his site, Dr. Doom explains how he became a Peak-Oil enthusiast to begin with, and then begins to explain how he started to doubt his initial conversion and eventually to realize that Peak-Oil is powered by an agrarian/utopian vision as much as by a realistic analysis of what is yet to come.

"I [began to see] "the hidden agenda of the powerdowners, namely, to bring about their utopian vision of the neo-agrarian society, no doubt with themselves its leaders. They know that most people won't willingly accept a return to centuries past, because most people are like me. ... But if people can be convinced that a powerdown is as unavoidable as gravity, they may bring it about simply by surrendering to it and not looking for alternatives. Scratch the surface of the powerdowner philosophy, and you'll find Marxism dressed up in radical environmentalism."

As a result of his newfound skepticism, Dr. Doom "started finding flaws in the logic behind [Savinar's site]. In due course, I found four whoppers. ..."

First, doomers tacitly assume that anything short of our current energy consumption level would be catastrophic. They also count as a shortage the expected growth in energy demand from industrializing countries like China and India, perversely using an expansion of modern civilization (that they don't believe can occur!) as further proof that it will collapse. Truth is, there is tremendous waste in our current use of energy. ... In an emergency, we could cut back even more, just like we did to win World War Two. It wouldn't be much fun, but it would be possible, and no one would have to starve. ... In the 1970s, conservation efforts and efficiency improvements in cars alone made a big dent in oil usage, enough that you can see it in the world's oil production statistics. Europe made the changes permanent by using taxes to keep demand down. The US didn't, so when the bottom dropped out of

oil prices in later decades, we went back to our wasteful ways. Europeans use roughly half the oil per person than the US does. This all proves two things: conservation can enable us to get along with less oil if we have to, and people respond in predictable ways to price changes.

The second flaw is in assuming that because we use oil to do something now, we have no other way to do it. In particular, doomers argue that none of the alternatives will work because they all require oil to implement. Wind farms and nuclear plants require oil to produce the materials they're made from, to transport the materials to the site, and to run construction equipment. Electric cars take oil to manufacture. Even coal mines need oil to run mining machinery. Once we run out of oil, we won't be able to do any of those things anymore, goes the argument. The most obvious problem with the argument is that while these activities require energy, the energy doesn't have to come from oil. We use oil for many of them now because it's cheap and convenient, but that doesn't mean we can't use another energy source when oil's no longer cheap or available.

The third flaw in the argument is a bit more subtle. It is the assumption that the energy required to switch to alternatives must come on top of what we are using energy for now, rather than instead of some of it. For example, Savinar argues that we won't have the energy to power a crash program of building efficient cars. This ignores the fact that we are already building cars, millions of them every year. The energy used to build them is already counted; the energy needed to build efficient cars doesn't just add to the total. It takes roughly the same energy to build an efficient car as an inefficient one. It would take 10-15 years to turn over the automobile fleet - it doesn't have to happen all at once.

The fourth flaw in the argument is even more subtle. Perhaps you've guessed it by now. Doomers argue that there is no energy source we can switch to that can take oil's place in modern civilization. That might or might not be true, but it's beside the point. No single energy source has to, provided we can put enough of the others together.

Dr. Doom's rebutal is convincing because the writer once believed the entire Peak-Oil argument and has since grown to reject it. But Dr. Doom still believes that oil is on its way out and that society is in the middle of adjusting to what will certainly become a newfound scarcity. This may or may not be true.

Consider, an article, "The Myth Of Peak Oil" by Paul Joseph Watson & Alex Jones at the alternative news site, Infowars. While the article dates from 2005, the arguments made have not substantially changed, and the conclusions reached and summarized at the beginning of the article can be supported today by those who remain skeptical of Peak Oil.

"Peak oil is a scam designed to create artificial scarcity and jack up prices," write Watson and Jones, "while giving the state an excuse to invade our lives and order us to sacrifice our hard-earned living standards." They continue as follows:

Globalization is all about consolidation. Now that the world economy has become so centralized through the Globalists operations, they are going to continue to consolidate and blame it on the West's "evil" overconsumption of fossil fuels, while at the same time blocking the development and integration of renewable clean technologies.

In other words, Peak oil is a scam to create artificial scarcity and drive prices up. Meanwhile, alternative fuel technologies which have been around for decades are intentionally suppressed. Peak oil is a theory advanced by the elite, by the oil industry, by the very people that you would think peak oil would harm, unless it was a cover for another agenda.

Watson and Jones cite internal memos in their article that seem to indicate that large oil companies do conspire to create artificial scarcity as best they can by closing oil refineries and stockpiling discoveries of oil without exploiting them. "Three separate internal confidential memos from Mobil, Chevron and Texaco have been obtained by The Foundation for Taxpayer and Consumer Rights," write Watson and Jones. "These memos outline a deliberate agenda to gouge prices and create artificial scarcity by limiting capacities of and outright closing oil refineries. This was a nationwide lobbying effort led by the American Petroleum Institute to encourage refineries. ..."

Watson and Jones also allude to "the mystery of Eugene Island 330 and self-renewing oil supplies." They report on Eugene Island, an oil field in the Gulf of Mexico, 80 miles off the coast of Louisiana. "It was discovered in 1973 and began producing 15,000 barrels of oil a day which then slowed to about 4,000 barrels in 1989. But then for no logical reason whatsoever, production spiked back up to 13,000 barrels a day. ..."

"What the researchers found when they analyzed the oil field with time lapse 3-D seismic imaging is that there was an unexplained deep fault in the bottom corner of the computer scan, which showed oil gushing in from a previously unknown deep source and migrating up through the rock to replenish the existing supply."

The replenishment that Watson and Jones refer to is often referred to as the theory of "abiotic oil." This is a kind of geological holy grail, a theory that maintains oil does not come from "fossils" – hence fossil fuel – but is developed deep in the earth's crust and gradually replenishes itself.

Supposedly the Russians have done a good deal of work supporting the theory of abiotic oil and it remains a fascinating alternative explanation to current proposals as to how oil is created. One may even, in fact, regard the current, popularly accepted explanations of oil's origin with some skepticism given that oil companies have gone out of their way to label oil a "fossil fuel."

The Argument for Gold (and Silver)

We have seen the pros and cons of Peak Oil, which is, bottom line, a case for owning oil. However, as convincing as some believe such a case is, there are many others who do not believe in Peak Oil and do not believe that oil is scarce at all. The recent volatility in the price of a barrel of oil, which saw a high of over US\$150 and then a subsequent low of US\$30 would seem to make the case for manipulation rather than a sustained Peak Oil scarcity.

But in any event, one need not make up his or her mind about Peak Oil to decide that the alternative, gold, silver or both may prove a less controversial choice. Unlike oil, silver and gold have shown a steady appreciation over the past decade and there may be good reasons for this. Silver, in fact, historically tracks gold prices, and reacts in much the same way over time, to the factors that influence gold, so there is merit in treating them as a unit.

Financial advisor Pat Gorman makes the case for money metals (especially gold) in his well-received book, "The Value of Honest Money" (ABP Release, 2008).

"Simply put," he writes, "you should know that silver and gold are money metals of market choice, having evolved from a competition between various kinds of commodities. Silver and gold are malleable, portable and attractive. These precious metals don't decay and thus hold their value. They can be turned into coins that can be circulated easily and can take a lot of abuse without losing shape, color or luster."

For Gorman, gold and silver represent a historical store of value in a way that oil simply is not. While oil has been an indispensable commodity in the modern world, the history of oil as a valuable element is about a century old. The history for gold is at 2,000-4,000 years old and silver may be 7,000-10,000 years old. What investors might well bear in mind, therefore, is that people have perceived of money metals as a store for value a lot longer than they have oil.

Gorman writes:

Today, silver and gold remain a primary store of value even though many people in the West don't realize it. A long campaign of disinformation about silver and gold, culminating in first the outlawing of silver-as-money and then, later, the confiscation of gold coins in the US and elsewhere has given people the idea that gold is a primitive form of exchange and that it has been superseded by paper currency and, more recently, by electronic transactions. ...

Central banks, for instance, continue to hold gold in massive quantities. And in the near and Far East, gold has never lost its luster. Today, the Japanese are heavy gold buyers. And more individuals in the West are buying gold bullion, coins, ETFs, mining stocks or holding gold through a variety of derivative instruments.

Among modern economists, perhaps Murray Rothbard has written most simply and clearly about the history of money. Books like "What Has Government Done to Our Money?" To begin with, Rothbard points out, there was no money, only trade — the swapping of one kind of resource or valuable commodity for another. Eventually, one resource became a repository of value itself — salt, shells, gems, or precious metals such as silver or gold. Ultimately, gold became a leading repository of value for most of the ancient world. It was light, beautiful, malleable and serviceable.

Silver, with many of the same properties, was a close runner-up. And throughout history, silver and gold have traded in a ratio with each other. People preferred it this way because if the ratio shifted dramatically, they knew that either the silver or gold circulating was likely debased. In this way, silver became the "commoners" money, while gold gradually assumed the role of money for a kingdom's "high finance."

Nowadays, the role and value of gold and silver are not perhaps as well understood as they were in previous times when precious metals circulated as actual money. The American experience with gold and silver can perhaps serve as a proxy for the world's larger evolution when it comes the relationship between gold and silver and the investing public. Gorman points out that the American War Between the States marks the turning point in the American relationship with money metals.

"Silver and gold were available as money in the United States before the Civil War," Gorman writes, "but came under pressure afterward. First silver was taken out of circulation and, in the 1930s gold was, too."

It is fair to say that gold and silver prices have suffered from the treatment they have received from governments around the world. Governments may have helped manipulate oil and oil byproducts to enhance both scarcity and prices, but a case can be made that the war on gold and silver has been both energetic and unrelenting. This has left many misunderstandings in the mind of the public about both the role and value of these money metals. Here's some more from Gorman on gold and silver's historical treatment in the US:

People didn't much like the transition from silver and gold to "paper money." In fact, when Congress decided that silver could no longer be directly circulated as "money," farmers in the United States "heartland" were furious with this decision. They called it the "crime of 1876." They believed that the removal of silver as money gave an advantage to the Eastern establishment which would now more easily be able to buy up Western farmland and lock away resources and land assets. In fact, this is just what occurred.

In the 1930s, at the start of the Great Depression, Franklin Delano Roosevelt did to gold what Congress had already done with silver: He outlawed its circulation. Even today, the use of honest money is looked upon with great

suspicion by the Federal authorities. "Money" has become what is printed by central banks. Thus, you and I — if we do not know better — keep most of our assets locked up in "paper" money. Such "money" was initially "bills" and could be presented to the US Federal Reserve for precious metals. Today, that option no longer holds. It took many centuries, but in the United States and most if not all of the rest of the Western world, honest money cannot be easily circulated.

Conclusion

It is popular these days to conclude that increasingly scarce oil and oil byproducts constitute a store of value that will appreciate far beyond gold and silver. The conclusion of this White Paper would be that such an assumption is untested historically and not necessarily valid.

In fact, as we have seen above, gold and silver have been stores of value for thousands of years and have maintained their value even in the face of worldwide government attacks.

At the same time, a case can be made that the value of oil and oil byproducts has been advanced by industry manipulations that, while effective in the short term, are not able to provide value much above historical averages for oil prices. A free-market analysis would tend to suggest that business manipulations of oil and oil byproducts cannot stabilize prices at a much higher level than those that oil and its byproducts have seen historically.

It is of course possible that oil and oil byproducts are really running out. But it does not follow that oil's value will then increase at a dramatic and ever-expanding rate. Oil's value is dependent on its utility and if other sources of power gradually expand to fill the gap left by shrinking oil supplies, then the upward pressure on oil valuations may cease.

When evaluating the argument of oil versus gold, one must also bear in mind that gold (and silver, too) are not in danger currently of being replaced, as oil is. Ultimately, oil is a commodity but gold and silver are MONEY METALS. This means that historically, gold and silver have been valued for their intrinsic worth. Oil has never been valued for itself, only for its utility.

Throughout history, commodity valuations have fluctuated but the prices of these commodities have usually reverted to "normal" over time (adjusting for price inflation). It is likely that the price of oil and oil byproducts will not much surpass the historical price average over time, absent the phenomenon of Peak Oil.

If an investor does wish to make the "oil bet," he or she is endorsing the concept of Peak Oil – one that this White Paper has attempted to show is controversial at best – and ignoring the history of gold (and silver's) historically consistent valuations.

CONCLUSION

Additionally, one may be ignoring the business cycle itself which is evidently supporting higher gold and silver prices as fiat-currency values continue to come under pressure. Oil may indeed see continued, significant price rises over the long term, though it is important to note that these higher prices have not so far been able to stick. Gold and silver prices may well see more appreciation because the business cycle currently supports increasingly favorable valuations.

Placing funds in oil and oil byproducts in the early 21st century, is a proposition that endorses to a degree the Peak Oil concept. Investing in gold and silver has historical validity and may be further enhanced by their positioning in the current business cycle.

NOTES

- Life After the Oil Crash (website) - Matt Savinar
- Peak Oil Debunked - "Dr. Doom" (blog pseudonym)
- The Myth Of Peak Oil - Paul Joseph Watson & Alex Jones
- The Value of Honest Money – Pat Gorman



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Chairman, Appenzeller Business Press AG

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