Porter Stansberry's
Investment Advisory
June 2008; Volume IX; 11

Freddie Mac and Fannie Mae Are Going to Zero

How to Protect Yourself from the Greatest Financial Calamity of our Lives

It began at 5:12 a.m.

The initial concussion ripped a gash in the earth – a 20-foot-wide crevasse through bedrock. In only 42 seconds, the wound spread across 296 miles.

The force of the rupture was approximately one gigaton, or 1,000 times more powerful than the nuclear bomb dropped on Nagasaki. Rarely in the history of our planet have more powerful forces been unleashed.

The earthquake was catastrophic. It destroyed one of the largest cities in the world in less than a minute. More than 3,000 people were killed, almost immediately, as their homes and apartments collapsed on top of them while they slept.

Never before in U.S. history had so many civilians been killed on a single day. (This grim record was maintained until the September 11, 2001, terrorist attacks.) But as horrible as the original destruction was, the disaster that followed was much worse.

INSIDE THIS MONTH'S ISSUE:

- The Beginning of the Real Mortgage Crisis
- How We've Made 12.8% in a Bear Market
- The BUD Deal
- Upgrading Nokia
- Another "No Risk" Buy

The cause of the real tragedy wasn't natural; it was economic.

Residents of the city, which was known to lie on top of a major fault line, were denied earthquake-damage coverage in their homeowner's insurance policies. They were not, however, denied fire protection. Thus, in the hours after the earthquake, many residents deliberately set fire to the remains of their homes, which had already been reduced to rubble.

With so many fires burning and with the city's water mains destroyed, firefighters could do little to stop the flames. The fire chief was dead, killed when his home collapsed in the earthquake. The surviving firemen and the local army garrison tried to contain the flames with dynamite and artillery shells, which caused more damage. Fires raged for four days and nights. More than 500 city blocks – the entire center of the city – were destroyed. The army was authorized to shoot looters on sight. Some 500 people were shot and killed for looting. (Some people were murdered while salvaging their own possessions, which the soldiers then looted.)

Insurance industry estimates put the total loss of the 1906 San Francisco earthquake at more than $400 million in 1906 dollars, or about 1.6% of the U.S. gross domestic product (GDP) at that time. For comparison, consider that Hurricane Katrina, the largest insured loss since the 1906 earthquake, destroyed property totaling 1% of America's GDP. In other words, the 1906 earthquake resulted in damages 60% more severe than Hurricane Katrina.

Back then, paying insurance claims involved moving huge amounts of gold bullion. The gold standard didn't allow the Federal

Reserve to create money with a printing press. And most of the gold owed to San Francisco residents was in the European bank accounts of giant insurers, such as Munich Re and Lloyd's of London. It took a long time for the insurance companies to withdraw their gold from the banks. But slowly, throughout 1906 and 1907, capital began to leak out of the banks and out of the capital markets. A huge amount of the world's capital made its way toward the reconstruction of San Francisco.

Banks, which normally enjoyed cheap access to capital, found it harder and harder to extend their short-term credit facilities – their lifeblood. As a result, they were forced to charge higher and higher rates for the margin loans extended to stock-market investors. As the supply of money began to dry up, more and more speculators were forced to sell their stocks simply because they could no longer afford the leverage they typically employed.

Observant market watchers saw the crisis developing. Some made fortunes by shorting the collapsing stock market. As Jesse Livermore related to Edwin Lefevre in his legendary history of speculation, *Reminiscences of a Stock Operator*:

> *Finally there came the awful day of reckoning for the bulls and the optimists and the wishful thinkers and those vast hordes that, dreading the pain of small loss at the beginning, were now about to suffer total amputation – without anesthetics. A day I shall never forget, October 24, 1907… No money anywhere, and you can't liquidate stocks because there is nobody to buy them. The whole Street is broke at this very moment…*

Jesse Livermore made more than $1 million on that day, covering his short positions as J.P. Morgan entered the fray, ordered banks to make their reserves available, and began buying stocks. Livermore saw his signal to start shorting when the railroads began advertising equity offerings that had earlier and earlier execution dates and accepted payment in installments.

The crisis of 1907, the banking panic it caused, and the recession that followed led directly to the creation of the Federal Reserve system we have today.

The creation of the Fed was supposed to make money panics a thing of the past. The banking cartel was supposed to ensure sound banks would always have money available. Much like the Titanic, though, the system got bigger, more powerful, and not one bit safer. The amount of money and credit available in the system became unimaginably larger, but the root cause of financial instability – too much leverage – was not abandoned.

This leverage is the root cause of the predicament in which America finds itself today. And if you follow the advice in this month's letter, it will make you a lot of money as two of our largest and most respected financial institutions collapse. But before we get to this month's opportunity, let me show you how it arrived at our doorstep…

The Mortgage Crisis Approaches Its Apex

Over the last 30 years, much of the greed in the world could be found in the heart of the U.S. consumer.

Facing stagnant-to-declining real wages, the constant erosion of the value of the U.S. dollar, and a startling growth in the size of the U.S. government (and its taxes), the consumer abandoned his savings and began selling the equity in his home, bit by bit, to finance his spending. As long as home prices continued to advance, the U.S. consumer didn't feel his standard of living falling.

And to facilitate the credit and capital required to sustain the historically unprecedented rise in home prices, the government sold to the public two government institutions: mortgage agencies Fannie Mae and Freddie Mac.

These two firms would now serve a dual mission: provide liquidity in the mortgage market and maximize profits for shareholders – *all beyond the regulation of the SEC*. Such a structure was an invitation for outrageous leverage, which both creates liquidity and maximizes profits (at least as long as home prices rise).

These quasi-governmental, public corporations would underwrite the entire U.S. mortgage market. They would package and guarantee mortgages, creating securities that could be sold around the world. And they would borrow capital on an enormous scale to buy mortgages, underpinning the market.

Investors, believing the government would never allow Fannie or Freddie to fail, began to treat their bonds as a kind of government debt, so-called "agency" debt. Global financial institutions, including most of the world's central banks, considered buying agency debt the equivalent of buying U.S. government debt.

And everyone got "rich." Homeowners saw the prices of their houses increase. Banks and central banks earned slightly

Published by **Stansberry & Associates Investment Research**

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higher yields in agency debt without taking on any extra risk (or so they thought). Freddie and Fannie, and their managers, reaped stupendous profits.

The only fly in the ointment was housing wasn't actually getting any more valuable; it was merely getting more expensive. As it got more expensive, new buyers had to borrow more and more money – even for their first "starter" home.

Signs of the overvaluation of real estate began to multiply. By the early 2000s, it was no longer possible in most markets to buy a property and rent it at a profit. Historical measures of affordability were left far behind. To compensate for the higher prices and the problem of poor affordability, more credit was extended under increasingly silly terms. No-money-down loans were made. Pay-option ARMs were invented, which allowed borrowers to avoid paying any principal on their loans for up to 60 months. Even borrowers who weren't creditworthy were extended loans – subprime mortgages soon made up 40% of the total market.

And throughout the entire period, Fannie Mae and Freddie Mac made more and more credit available to homebuyers.

Today, on a combined basis, 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.

I submit to you: Both stocks are certainly and clearly already zeros.

For those of you who don't work in the financial industry, it might be hard for you to immediately grasp what's so dangerous about the extreme amount of leverage employed by Fannie Mae and Freddie Mac.

Let me explain exactly what Fannie and Freddie do and why they're in so much jeopardy...

First, Fannie and Freddie act like a mortgage-securities investment bank. They package mortgages and guarantee their principal so that other institutions will buy the mortgages, which greatly increases the investment demand for U.S. mortgage debt. They earn a fee for providing this guarantee. [Options traders can think of it this way: Fannie and Freddie have essentially sold a "put" option, or insurance, on the value of the U.S. mortgage market. As any good trader knows, selling puts is a great business until there's a panic.]

The second thing Fannie and Freddie do is borrow money at cheap, short-term interest rates and buy long-term, higher-yielding mortgages. This is the classic operation of a mortgage bank – they borrow short, lend long, and earn the difference between short-term and long-term rates. How much money they make is a simple function of the size of the difference and the amount of capital they can use. In this bank-like business, Fannie and Freddie have enjoyed a tremendous advantage. The market assumes the U.S. government will not allow them to fail; thus investors have been willing to extend Fannie and Freddie enormous amounts of leverage at a very low cost. Fannie and Freddie earn most of their profits this way.

Imagine if your credit was superb and all of your neighbors wanted to lend you money. You were supposed to be a genius at buying houses, fixing them up, and selling them at a profit. Using your own net worth (say, $100,000) to finance your purchases, you could maybe buy one or two houses a year. But your friends organized a $1 million, one-year bond for you. In return for the $1 million, you had to put up your $100,000 and the homes you were to buy as security on the note. Plus, you agreed to pay your friends 8% a year for the financing. You're now leveraged 10-to-1. Suddenly, instead of earning $20,000 a year on your $100,000 in capital, you were able to earn $200,000 a year using $1 million of borrowed money. Your return on equity jumped from 20% to 100%. Nothing changed about your margins; you could simply buy 10 homes a year instead of one.

Wow, you thought… that's great. So next year, instead of borrowing $1 million using $100,000 plus the homes you bought in collateral, you decided to borrow $2 million against your $100,000 in equity. You bought 20 homes this time. But… the market turned sour. You couldn't resell any of the homes. At the end of the year, you couldn't repay the loan. Your friends said, "Hey, don't worry about it, the debt is secured by the value of the homes." There's only one problem. An accurate estimate of the value of the homes shows they'd

fallen in price by 10%. That's a $200,000 loss. Your friends said, "We're happy to extend the note another year, but you have to put up more collateral because the value of the real estate is down $200,000 and you only put up $100,000."

Your equity has been wiped out. Unless you can raise another $100,000 to satisfy your lenders, you'll end up in default on your note.

This is exactly what's been happening to the investment banks that owned a lot of mortgages – Merrill Lynch, Citigroup, Bear Stearns, Lehman Brothers, Fannie Mae, and Freddie Mac. The Federal Reserve has helped them by allowing them to exchange mortgage notes of dubious value for Treasury bonds on a 28-day basis. While this has provided emergency liquidity to the market, it doesn't solve the problem. Sooner or later, these firms will have to liquidate their mortgages and take huge losses. The more leveraged they are, the more likely it is they'll be wiped out.

Fannie and Freddie are the most at risk because they're hugely leveraged and because they own nothing but U.S. mortgages.

No doubt, even if an orderly market could be made for the liquidation of Fannie or Freddie's assets, the current market value of the mortgages held on their balance sheets has fallen by at least 5%, wiping out all of their equity. Given the off-balance-sheet guarantees these firms have sold, it is absurd to believe they are still economically viable.

Freddie and Fannie own slivers of just about every kind of mortgage – even the toxic stuff. In Fannie's book, for example, we find nearly $400 billion worth of subprime and Alt-A mortgages. Since we know 57% of their mortgages were underwritten in 2005 or later, we know at least a sizeable portion of their mortgage book (say 25% to 40%) is deeply underwater.

How have Fannie and Freddie avoided their reckoning day?

By moving more and more of their assets into the so-called "Level 3" category. Level 3 assets are financial assets whose price can only be *estimated* by management because the market for such assets isn't liquid enough to provide a firm price. For example, Freddie Mac's first-quarter report shows it now holds $155 billion in Level 3 assets. According to my sources, these are subprime mortgages originated by now defunct mortgage companies, which can't be sold at any price. Freddie Mac's Level 3 assets total 23% of all of the mortgages it owns. Assuming these mortgages are only worth 50¢ on the dollar (far more than they're likely to fetch), this loss alone would be enough to bankrupt the shareholders, never mind any of its other problems or guarantees.

Most people simply haven't considered what a huge problem this creates because most people don't realize how important the U.S. mortgage market has become to global liquidity. Ten years ago, the total U.S. mortgage market was about $3.5 trillion, roughly equal to the U.S. Treasury market. Today, the U.S. Treasury market has grown to $4.5 trillion. But the U.S. mortgage market has more than doubled to about $9.5 trillion. These mortgages, packaged into securities guaranteed by Fannie Mae and Freddie Mac, make up the reserves of financial institutions all over the world. As these securities fall in price, they're reducing the amount of available outstanding credit globally on a leveraged basis.

And since 2006, the money has been slowly drying up, just as it did following the San Francisco earthquake. Meanwhile, demand for capital is soaring, as all of the banks and brokerage firms try to repair their balance sheets on the heels of massive losses in the mortgage market.

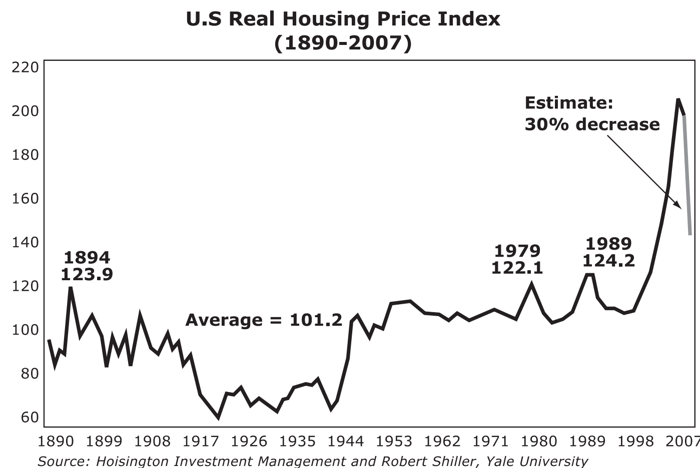
Financial companies have written down more than $300 billion in mortgage losses since 2006. As these reserves disappear, firms must either sell their investment assets (reducing global liquidity) or raise new reserves. Just one firm, Merrill Lynch, has raised $37 billion since last July – on a base of just $31 billion in shareholder equity! Its longtime shareholders have suffered greater than a 50% dilution.

Firm after firm has been trying to raise capital before the money runs out, just like the railroads did in 1907. And like they did then, financial institutions are using innovative ways, like convertible preferred shares, to entice investors to buy into their stock at a sharp discount from its market price. Even so, firms are beginning to discover no more money is available. That's what happened to Bear Stearns. As its mortgages lost value, it couldn't raise enough capital to pay for the losses, thanks to extreme leverage, about 30-to-1.

To stop the panic brought about by the failure of Bear Stearns, the Federal Reserve is doing what J.P. Morgan did in 1907. It's providing emergency liquidity. But keeping securities firms (Lehman Brothers, for example) afloat with 28-day revolving debt doesn't address the problem. The securities (U.S. mortgages) against which a large part of the world's financial assets are leveraged have significantly and permanently declined in price. All the king's horses and all the king's men can't put Humpty Dumpty back together again.

This will come as a shock to most Americans alive today, but absent inflation, home prices normally don't appreciate. Long-term studies of U.S. housing prices show residential property, on average, didn't appreciate at all in the 100 years between 1890 and 1990. But, since 1990, in real terms, residential property doubled. Thus, even if property prices were to decline by 30% on average (twice as much as they've fallen already) housing will still be 40% more expensive than its

historic average.



James Lockhart, director of the Office of Federal Housing Enterprise Oversight (Fannie and Freddie's regulator) has begun to sound the alarm that something must be done to save Fannie and Freddie's operations (if not their shareholders). On May 17, he told the *Wall Street Journal* the two firms are at "a point of vulnerability for the financial system" and "could pose significant risk to taxpayers as well as to the financial institutions and other investors."

I hope the irony isn't lost on you… The man in charge of regulating these firms now says they've become mortal dangers to the U.S. economy. What's more ironic is what Fannie and Freddie are doing about the situation. They've persuaded Congress to lower their capital reserve requirements so that they can buy still more mortgages!

In April, Freddie Mac increased the size of its mortgage book by 42% on an annualized basis. Rather than raising capital and decreasing its exposure to mortgage risks, Fannie and Freddie appear to be taking exactly the opposite course. They're increasing their leverage and increasing their exposure to mortgages. They've also begun using every possible accounting trick to boost the apparent size of their capital base. They've added deferred tax assets to their books. They've jimmied with the accounting treatment of the losses in their off-balance-sheet guaranteed portfolios, putting off recognizing the losses while realizing the fees gained from selling the securities now.

The strategy seems to be to avoid the crash by re-inflating the credit bubble. But no amount of money will change the fundamentals of the U.S. housing market because sentiment has shifted strongly to pessimism. The crisis of 1907 wasn't really caused by the earthquake; the fires that followed the initial destruction caused it. Likewise, the financial crisis I expect we'll see develop in the second half of this year will be caused by the follow-on effects of the housing bust. The worst follow-on problem will be "jingle-mail" – people mailing in their keys to their mortgage companies, voluntarily giving up their home instead of paying their mortgages. In markets where homes prices have fallen by more than the average down payment, it may well pay for homeowners to renege on their mortgages and mail in their keys.

Falling prices, growing backlogs of unsold homes, jingle-mail, a gradual reduction of available credit, and finally a financial panic as hundreds of banks and other institutions fail…

If home prices continue falling, this is exactly what will happen. And I don't see any way to avoid home prices continuing to fall. The tide has turned.

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 (NYSE: FNM, $27.59) and Freddie Mac (NYSE: FRE, $25.29) are going to zero.

At some point in the future, they will be unable to raise additional equity at any price. And the next day, their shares will no longer trade. **I recommend you sell an equal amount of each stock short.** I have so much confidence in this trade I recommend you use a 25% stop loss, not a trailing stop loss, as the position could be volatile for the remainder of this year. And unlike most short sell positions that I recommend you buy to cover after you're up 50%, I recommend you hold these positions until the shares literally no longer trade.

How to Survive and Prosper in the Midst of a Growing Financial Crisis

My theme song for this year has been *Stayin' Alive,* the insanely high-pitched disco-era pop song by the Australian pop group, The Bee Gees.

Much to the annoyance of the marketing staff that shares the ground floor with me in our offices at 1217 St. Paul Street, when the stock market has a particularly bad day, I launch the iTunes application on my computer and play the song at high volume. Over the last 12 months, stocks have fallen by about 10% on average, as measured by the S&P 500. On the other hand, our recommendations during the same period show a small average gain – about 4%. We are stayin' alive – just barely.

But we knew it was going to be a tough year for stocks, as we warned you in our January 2008 letter.

I now believe our country's mortgage crisis will spill over into

the general economy because the fallout has already spread from development companies to mortgage banks to investment banks and now to credit-card companies… This is a time to be extremely cautious with your own finances. I believe the S&P 500 will fall this year, by more than 10%. Most stocks will probably decline this year. Thus, simply holding cash isn't a bad strategy right now – your cash will probably outperform your stocks in 2008.

Our strategy for long-term success in the midst of a bear market is to position our portfolio in progressively higher-quality stocks – companies that under normal economic times would be far too expensive to be purchased safely. Additionally, we've hedged our long position by selling covered calls to generate income, and we've periodically sold stocks short, as we're doing again this month.

Selling calls against our positions has been particularly profitable for us. We've launched four new covered call positions – **Moody's (NYSE: MCO), JDS Uniphase (Nasdaq: JDSU), WellPoint (NYSE: WLP), Starbucks (Nasdaq: SBUX)** – over the last few months. All are solidly in the black with an average gain of 12.8%. Thanks to a minor scandal regarding Moody's computer models last month, the stock took a short-lived dive, putting the calls we sold ($40) out of the money. Thus, you should be able to sell another contract against your shares. I recommend selling the **MCO January 2009 50 calls (OWCAJ)**. You should get something around $2.75 for these calls. With $5.83 in call premium already earned in the position, we've now generated $8.58 in income from selling calls. We bought one of the highest-quality businesses in the world… and made more than 18% in less than a year simply waiting for the price to bounce back. With any luck, we'll continue to hold onto the stock, which I continue to believe will be an outstanding performer once the mortgage crisis passes.

Judging by the feedback e-mails I've read, more than a few of you have sold all of your stocks and have simply been waiting out the mortgage debacle in cash, on the sidelines. That's certainly the safest way to play it, but when I look around the markets and see names like **Duke Energy (NYSE: DUK)**, **Verizon (NYSE: VZ)**, **Microsoft (Nasdaq: MSFT)**, **Hershey (NYSE: HSY)**, **Intel (Nasdaq: INTC)**, **Nokia (NYSE: NOK)**, **Markel (NYSE: MKL)**, **Johnson & Johnson (NYSE: JNJ)**, **Anheuser-Busch (NYSE: BUD)**, WellPoint, Starbucks, and Moody's selling, in many cases, for less than 10 years' worth of cash from operations, I feel like you simply must buy these names, regardless of how rocky the road might be over the short term. These stocks are members of America's corporate hall of fame. Buying these legendary corporations at such great prices will ensure you an excellent return over the next five to 10 years – and beyond.

I sincerely hope you recognize the scope of the opportunity we've had in these stocks. Looking at my "No Risk" and "Forever" portfolios, it's hard to imagine a higher-quality mix of stocks – and most of them are trading at once-in-a-decade low prices. Without the terrible problems in the mortgage and finance sectors, these values wouldn't be available. And that's why, despite the risk to the market overall, we will add another icon of American business – **Texas Instruments (NYSE: TXN)** – to our "No Risk" portfolio.

TI is one of the best-managed companies in America, with returns on equity of more than 25%. It has a bulletproof balance sheet – $12.6 billion in assets held against only $2.6 billion in total debt. It treats shareholders extremely well, with a share buyback program that's purchased an amazing $12.5 billion worth of stock over the last three years – 30% of the stock outstanding. Combining the cash dividend with the estimated buyback this year, you get a synthetic yield of more than 10%.

I've only seen one other large technology company capable of returning so much capital to shareholders, Nokia. And like Nokia, TI is the market leader in its two leading products: analog semiconductors and digital signal processors (DSPs). TI has gained market share with these products in each of the last six years. To get an idea of how dominant TI is in its core markets, consider that 75% of all notebook PCs use TI chips for power management and data storage.

But TI's products end up in far more devices than just computers.

Analog semiconductors connect digital systems to real world signals – such as sound, temperature, pressure, and visual images – and convert them into digital form. TI is the world's largest supplier of analog semiconductors, selling to more than 50,000 customers around the world.

As computers become smaller, more efficient, and less expensive, demand for analog semiconductors to link imbedded computer systems to the environment will rise. This is TI's main growth business. And that's great news for investors because TI has a true edge in analog.

Manufacturing cutting-edge computer chips is a notoriously expensive endeavor. Each generation of chips becomes obsolete very quickly. New fabrication equipment must be purchased – it's a never ending "technology treadmill."

But analog chips are much more "plain vanilla." They can be manufactured with older, less-sophisticated equipment. On the other hand, making them with cheaper equipment requires a proprietary process, which TI has mastered. This gives TI a substantial "moat" in the analog business. TI can build better chips, for less. That's why TI is able to earn bigger profits and

higher returns on equity than its competitors.

You have three good reasons to buy TI for your portfolio right now. First, the global demand for the kinds of semiconductors TI makes is unlikely to be hurt by the U.S. mortgage debacle. TI sells chips to almost every country in the world. Second, the falling value of the U.S. dollar makes it easier for TI to compete with its Asian and European competition. It's very likely to produce better-than-expected sales and earnings growth as long as the dollar remains weak. And third, it's unlikely you will lose money buying shares of TI at the current price.

As longtime readers know, I'm a big fan of buying stocks that are trading for a "no risk" price. TI definitely qualifies. What that means is, given its current cash earnings and balance sheet, TI could easily finance the purchase of all its shares and debt outstanding. Specifically, TI has an enterprise value (market cap minus net debt) of $40 billion. It's currently producing about $4.5 billion in cash from operations annually. Assuming TI would have to pay something like 8% interest on a debt transaction to go private, it would require $3.2 billion annually to pay the interest on the debt required. So it could easily afford to buy itself.

While the board of directors isn't likely to take this course of action, such a low price does make TI a target for private-equity firms and other strategic buyers. Also, technically, since the board of directors has a legal, fiduciary duty to shareholders, if the price of TI were to fall much, the board would be under pressure to take the company private at a premium. All of this means, at such a low price it's hard to imagine we'll lose money buying shares of Texas Instruments, despite the lousy prospects for our economy.

As we've been doing with most of our "long" recommendations, given our bearish outlook on the stock market, it probably makes sense to sell a call against your shares, at least through the end of the year. But the January 2009 37.50 calls only trade for a little more than $1 – that's only a 3.75% yield. Given the company's huge share buybacks, I don't think it's worth it to sell the calls. TI's stock is very likely to be above $37.50 by next January. I don't think the premium is high enough to justify being called away from the stock.

Buy shares of Texas Instruments (NYSE: TXN). Use a 25% stop loss.

Portfolio Notes

A little over two years ago, in March of 2006, I metaphorically jumped up and down and begged you to buy shares of **Anheuser-Busch (NYSE: BUD)**. In fact, never in my career have I advised establishing such a large position in one stock:

> *At a minimum, I recommend you establish a position equal to double your normal initial stake. If you're a 4% guy or gal, take an 8% stake this month. If you always buy more than I recommend, really double up this time. You can go as high as 25% of your equity portfolio with my blessing. Sell whatever it takes to free up the capital you need. Buy that new car next year. Turn down the heat. Whatever it takes: make sure you act on this month's recommendation. Don't wait.*

Since that time we're up almost 50% on the stock, which as I'm sure you've seen is "in play." Rumors in the market suggest global brewer InBev will make an offer for the stock. If so, we'll probably make another 15%-20% in the short term, netting us close to 70% in two years. Given the safety of this stock and the market's poor results over the period, that's an outstanding result. If I could find a buy like that every time I sat down to write a letter to you, I'd have the easiest job in the world. I truly hope you followed my advice and put a big chunk of your portfolio into BUD.

Regarding the InBev deal, even though it will probably hurt us in the short term, I actually hope the deal doesn't materialize. I think Bud's unique brand is too valuable to risk and its properties in China are the most valuable alcohol businesses in the world. I doubt we'll get anything like their intrinsic value from InBev.

Verizon Wireless announced a nearly $30 billion deal to buy one of its biggest U.S. competitors, Alltel. I like the deal for one reason: Alltel operates a CDMA wireless network, which is the same basic technology Verizon Wireless uses. Integrating the two networks should be seamless and the projected $1 billion cost savings for **Verizon (NYSE: VZ)** will materialize.

You'll notice that I've strongly upgraded **Nokia (NYSE: NOK)**, ranking it a No. 1 buy right now. The move is purely in response to the stock's declining price. The business continues to perform. Nokia is one of the world's truly great businesses. If you don't own it, now is the time to buy.

Good investing,

Porter Stansberry
June 6, 2008

Porter Stansberry's Model Portfolio

Prices as of June 5, 2008

"No-Risk"	Symbol	Ref. Date	Ref. Price	Recent	Dividend	Description	Action	P/L	RISK
Microsoft	MSFT	Jul-06	$23.48	$28.30	$0.82	Blue-chip software	Buy	24%	1
Duke Energy	DUK	Jun-07	$19.54	$18.17	$0.66	Nuclear power	Buy	-4%	1
Verizon	VZ	Feb-06	$31.54	$38.96	$5.20	Blue-chip telecom	Buy	40%	1
Nokia	NOK	Jul-04	$14.65	$26.78	$2.23	Profitable telecom	Buy	98%	1
WellPoint*	WLP	Apr-08	$46.34	$56.48	$3.00	Largest HMO		28%	2
Hershey	HSY	Dec-07	$40.55	$38.59	$0.60	Chocolate empire	Buy	-3%	2
SK Telecom	SKM	Mar-07	$22.51	$22.24		Korean telecom	Buy	-1%	2
Telecom New Zealand	NZT	Jan-08	$16.85	$15.10	$0.65	Telecom monopoly	Buy	-7%	2
Texas Instruments	TXN	Jun-08	NEW	$32.03		Analog chip leader	Buy	NEW	3
Starbucks*	SBUX	May-08	$15.85	$18.52	$1.00	Drug dealer	Buy	23%	3
Intel	INTC	Apr-06	$19.35	$23.87	$1.02	Silicon leader	Buy	29%	3
Chunghwa Telecom^	CHT	Aug-07	$17.60	$25.45	$0.25	Taiwan's Verizon	Buy	46%	3
Raytheon	RTN	Nov-02	$29.00	$61.87	$4.94	Defense	Hold	130%	5
Valhi	VHI	Mar-05	$16.20	$30.97	$18.82	Simmon's holding co.	Hold	207%	5
Exelon	EXC	Oct-02	$21.50	$89.69	$8.40	Nuclear power	Hold	356%	5
The "Next Boom"									
JDS Uniphase*	JDSU	Mar-08	$12.45	$12.67	$1.00	Bandwidth king	Buy	10%	4
Forever									
Markel	MKL	Oct-07	$486.51	$415.50		Public hedge fund	Buy	-15%	1
Johnson & Johnson	JNJ	Jul-06	$60.52	$66.96	$3.25	Blue-chip health	Buy	16%	2
Moody's Corp*	MCO	Sep-07	$46.03	$41.38	$8.68	Financial rebound	Buy	9%	3
New York Times^^	NYT	Feb-08	$16.74	$17.42	-$2.77	Blue-chip newspaper	Buy	-12%	3
Covanta	CVA	May-07	$24.38	$27.57		Zell's holding co.	Buy	13%	3
Anheuser-Busch	BUD	Mar-06	$41.38	$57.75	$2.77	Global brewer	Hold	46%	4
Victims									
Capital One Financial	COF	Apr-08	$49.62	$49.62		Bad debt	Sell Short	0%	7
Fannie Mae	FNM	Jun-08	NEW	$27.59		Bad mortgages	Sell Short	NEW	7
Freddy Mac	FRE	Jun-08	NEW	$25.29		Bad mortgages	Sell Short	NEW	7
						Current PSIA Average		**47.6%**	
						S&P 500 2008		**-4.4%**	

* Dividend figure represents proceeds from call sales.
^ Reference price adjusted for reverse split.
^^ Dividend figure includes cost of put options.
Please note: our investment philosophy limits risk through the use of stop losses and trailing stop losses. Unless otherwise noted below, all "Next Boom" recommendations use a 25% TRAILING STOP LOSS; "No-Risk" recommendations use a 25% STOP LOSS; and all "Forever" recommendations carry no stop loss.
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Our risk label is based mainly on current share price and the nature of the business.
1 = the lowest possible risk. 10 = the highest possible risk.

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