Thinking Outside the Box

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Special Report By Money Chronicles

Making Money in Precious Metals & Gems

Six Good Reasons You Should Hold Gold

The gold price has risen 44% in the last three years. Despite corrections along the way, gold seems to be at the start of a real bull market. Has the yellow metal's day finally come? Yes, says veteran gold investor Doug Casey.

Over the summer, the gold and silver prices both suffered significant price corrections and, last week, after a nice run up, prices corrected again — along with those of most of other metals. That scared a lot of people. Every time there's a drop, they think the metals bull market is over. I don't think it is. Markets fluctuate more or less randomly in the short run, which helps account for why 95% of futures traders walk away losers. People with such a short time frame shouldn't be in the markets; they should go to casinos. The key is to identify major trends in the markets, understand why they're occurring, and stay with them for as long as possible. Jitterbugs who worry about daily movements will eat their capital up with commissions, taxes and spreads.

I don't have a crystal ball, but I do have a sense of market history. Most of the active players in the last real gold bull market, from August 1971 to January 1980 (which took gold from $35 to over $800), are now dead or retired. Most players today only know of gold as a dog, dropping from over $800 to under $253 in July 1999. Those few who watched the 22-year slide came to see every rally as a selling opportunity. Understandably, people tend to predict the future in light of the past. So they expect bull and bear markets to go on forever. Gold has now moved from $252.80 at the bottom to present levels around $415. But most still see the move as just another rally in a never-ending bear market.

How do I know they're not right? Well, nobody can be sure. But I've been long on the metal and gold stocks since the late 1990s (I was too early in; generally speaking, only liars buy at the exact bottom), and I'm planning on staying long for the indefinite future. Why am I so bullish? There are six outstanding factors that I believe will almost certainly cause the dollar price of gold to rise.

1. The U.S. foreign trade deficit

The U.S. is currently importing about $500bn more than it exports every year. That's been getting worse for many years, so there are trillions of U.S. dollars now held outside of the U.S. Since U.S. dollars are only legal tender within the U.S., whether foreigners continue holding them depends on whether they have confidence in the dollar; confidence can vanish like a pile of feathers during a hurricane. I would suggest that they're becoming increasingly aware that the dollar is, in fact, an "IOU Nothing" on the part of the U.S. Government. And historically, when the dollar falls, the gold price rises.

2. U.S. government deficits

The U.S. government is also running \$500bn domestic deficits. That number is probably already understated, but either way it's likely to go way, way up. Why? It's being financed with some of the lowest interest rates in history, and when rates cyclically rise to more normal levels (remember 15% long rates of the last generation? I expect they will be exceeded), the deficit could reach a trillion. That's not counting greatly diminished tax revenues and the greatly increased government spending that always accompanies a recession — something I think we'll see before too long.

3. The war

My guess is that the adventures in Iraq and Afghanistan are going to get more ugly and spread to other parts of the Islamic world. The U.S. isn't going to withdraw but become more involved. This could be a \$200bn per year drain, on top of the regular Defense Department and Homeland Security budgets, for many years to come.

4. Supply and demand

Although most of the gold that's ever been mined is available (either as bullion, coins, or jewelry), the fact is that more is being consumed than is being mined each year by a substantial margin — about 640 tons in 2003 alone. Most of this deficit has been made up by sales and loans from central bank inventory, compounded by forward sales from gold mining companies. The loans and forward sales constitute a short position of substantial size that will have to be covered. And my suspicion is that, at some point in the next few years, central banks will go from being net sellers to net buyers.

5. The real price

When it was trading at \$35 in 1971, gold was artificially suppressed in price by government edict. By the time it reached \$800 in 1980, it was caught up in a speculative mania. Since then it's achieved some equilibrium. But \$400 today is only worth about \$75 in 1971 dollars, so it's quite under priced. And, in real dollars, gold isn't down just 50% from its 1980 peak — it's still down about 85%.

6. Gold as a currency

Take your pick: a piece of paper with less than zero intrinsic value, or a tangible and relatively rare metal that has been viewed as a store of wealth over thousands of years. You want to own gold for all these reasons. But, above all, you want to own it because it's the only financial asset that is not simultaneously someone else's liability — which is why I expect central banks around the world will increasingly be selling dollars and buying gold. It's effectively insurance against everything.

I believe there'll be a gold bull market of historic proportions in the years to come. Retrenchments such as we're seeing now are not only normal, but trivial. You should use them to buy bullion and aggressively add to your mining share positions. Despite strong returns almost across the board in these stocks, there's every reason to believe that when the gold bull really gets under way, these stocks will be wilder than tech stocks were in the late 1990s. And, thanks to the recent correction, the prices on many of the most attractive stocks have fallen back — providing what could be one of the last great opportunities to buy low. Sticking my neck out, I think we'll see gold prices surpass $3k before this decade is over. I know that is hard to imagine, but history is littered with sweeping economic dislocations of far greater magnitude.

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Gold bull has barely begun

With the price of gold going up, you might be tempted to take profits on any gold holdings. But the global economy is still in turmoil and the supply of gold is tight; further price increases — of up to 700% — by the end of the decade look likely.

Towards the end of last year gold hit 16-year highs at $450 and is currently trading at around $420 an ounce. So what's next for the yellow metal?

The answer is a long-term bull market. Those who have held on to gold throughout the long-bear market of the last 20 years might be tempted by the price rise over the last few years to count their blessings, sell up and move on. But that would be a mistake. To see why, think about the last bull market in gold — when the price hit $850 an ounce in 1980 (2,000% up from its lows), says Brian Durrant in *The Fleet Street Letter*. There was escalating tension in the Middle East, mainly centered on Iran, U.S. government policy was in disarray abroad, oil prices were surging (they moved from below $15 a barrel in December 1978 to $39 a barrel in February 1981) and the dollar was weakening.

Sound familiar? It should. The conditions that provided the background for a speculative frenzy then are fast being replicated today, and that means there are several very good reasons to hold gold.

Gold is the best insurance

Bad news is good news for gold: it loves misery, and it loves uncertainty, and there is certainly plenty of that about. It is "a matter of conjecture," points out Brian Durrant, as to whether the re-election of George Bush has made the world a safer place or not, but certainly the problem of Iran — its determination to develop a nuclear capability, coupled with America's determination that it shouldn't — doesn't bode well for 2005. As the threat of military action rises, so will the price of gold, the world's ultimate safe haven.

Gold has also proved an excellent hedge against inflation and hence the debasement of paper currencies. Gold has certainly stood the test of time in a way that no paper currencies yet have. And inflation is becoming more and more of a danger. The last three big flare-ups in inflation have been fuelled by huge rises in oil prices — it happened in 1973, in 1979, and again in 1990.

And now oil prices have soared again, rising fourfold since 1998. That's beginning to show up in the numbers. Finally, gold is the perfect hedge against the falling dollar: as the dollar keeps falling (as it surely will), the gold price will keep rising.

There isn't enough gold

This means that demand for gold is rising fast. Investors want it, but consumers want it too. Numbers out from the World Gold Council show net consumer demand up 6% in sterling terms and 17% in dollar terms in the third quarter of last year. Demand from the Middle East and China was strong, but the best performances came from India, already the world's largest market, where demand rose 16%, and Japan, where it soared 74% year on year, largely thanks to the popularity of Senryobako treasure boxes — wooden boxes filled with ten kilo bars of gold or gold coins.

Yet the supply is not there to meet this demand: over the same time period, the World Gold Council notes that supply was "sharply reduced" at 828 tons, 22% below the level of supply in the third quarter in 2003. The fact is that more gold is being consumed than is mined every year, something that will underpin the price over the long term.

On the way to $3,000 an ounce?

The gold price won't rise in a straight line (markets never do), so while everyone should be holding gold in their portfolio — 10% according to Frank Holmes, chief investment officer at Texas-based U.S. Global Investors — they'll need to be prepared for some volatility. Some gold bulls, such as Dan Denning, the editor of *Strategic Investment*, think that the 16-year highs hit late last year represent a short-term high for the gold price, for example. "In contrarian terms," says Denning, "whenever the crowd is all on the same side of the trade, the trade is nearly over." But what about the long term? "I'm a mega-bull," he says.

So is Christopher Wood. Gold is not really going to start attracting the attention of mainstream investors until it starts appreciating in all currencies, rather than just the dollar, he says on *Breakingviews.com*. This hasn't really happened yet, but it will. Wood has a bullion price target of $3.4k by the end of this decade. Veteran gold investor Doug Casey isn't far off that. "Sticking my neck out," he told us, "I think we'll see gold prices surpass $3k before the decade is over." That would mean a rise of more than 600% in the price of the metal.

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Why you should stock up on silver

Silver looks like a serious investment proposition, says Jack Dyson. It has multiple applications, is highly versatile, yet looks distinctly undervalued.

What's so special about silver?

The most plentiful and least expensive of the precious metals, silver has been used in jewelry and as hard currency for centuries. From ancient Greece and Rome to the old silver dime in the U.S., a silver coin has historically been the equivalent of a day's wages. For five hundred years until the mid-19th century, it took between 15 and 20 ounces of silver to buy one ounce of gold. Now that ratio is 58:1. With that sort of benchmark in mind, some analysts argue that silver is distinctly undervalued. Silver has some heavyweight fans too. Warren Buffet bought 130 million ounces of real silver in 1997 — as much as he was legally allowed to buy — and has since been joined in the market by George Soros (who owns a large percentage of Apex Silver) and Bill Gates (who is said to own more than 10% of Pan American Silver).

Why invest in silver?

Supply and demand: every year we are using more silver than we mine. Demand has outstripped mined supply for the past decade, with an average annual deficit of 133 million ounces. Silver bulls say that makes investing in silver a no-brainer: if the dollar continues to fall and the financial markets suffer, both silver and gold will rise as investors make the flight into quality. Equally, if the global economy flourishes and China continues its aggressive growth, then more silver will be needed, and the price will rise.

How has the price of silver performed?

As well as being known as "poor man's gold" and "the white metal", silver is sometimes called "the restless metal", because of its volatility. It is a small and thinly traded market, and hence prone to dramatic movements. Last April, having risen sharply over several months to $8.29 an ounce, it plummeted 32% in a month. At the end of 2004, it slid 17% in seven days from $8 to $6.50, and has since risen back to $7.37.

Over the long-term, though, the trend is up.

Isn't the silver market easily manipulated?
For the past few years, allegations that the silver price is being artificially held back have been picking up steam. According to the price-fixing argument, the reason for the oddly low price is that a cartel of silver managers has artificially increased supply, by buying the metal from central banks such as China's, in order to depress the price. There is further conjecture that for the past 20 years a group of commercial traders have held short futures positions so large that they cannot serve legitimate hedging purposes, because they can't be backed by real

silver. This has created perfect conditions for a mammoth price spike, because stocks are now so low that the short positions are rapidly becoming untenable.

Are these rumours true?

Last May, Michael Gorham, then the director of the U.S. Commodity Futures Trading Commission, published an open letter aimed at reassuring silver investors. He said that while there was a production deficit, there was as yet no supply deficit, though supply was certainly falling. According to Gorham, the allegations of manipulation are the result of a sinister spin being put on perfectly normal hedging strategies, where the total open-futures contracts holdings often exceed the ability of traders to make actual physical delivery against them.

So how do I invest in silver?

The low price means that direct physical ownership is a viable option. It's relatively easy to buy silver and store it as bullion, or in bags of scrap silver. Futures, or spread bets, are probably the simplest way of actively trading the metal, but you can end up taking big losses from comparatively small movements in price.

What about stocks?

If you want to buy silver stocks now, you could invest in U.S. silver miners such as Pan American Silver, Hecla Mining and Silver Standard. However, fully to take advantage while silver is still a contrarian play, Doug Casey in *International Speculator* recommends that investors consider Toronto-traded Silver Wheaton (SLW). Originally CEO of Wheaton Gold, the company's boss, Ian Tefler, has a terrific track record and a sound strategy; Silver Wheaton is quite simply "a brilliant piece of financial engineering," says Casey.

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An investor's best friend?

Most diamonds aren't forever, says Natasha Langan. Neither are most emeralds, sapphires and rubies. If you want to make money out of investing in gems, you've got to pick your targets very carefully.

There is something amazingly compelling about gems, and it isn't the fact that they sparkle when the light catches them. Glass and cheap garnets do that just as well. No, the real attraction of diamonds, emeralds, sapphires and rubies lies in our belief that their rarity makes them special, both in terms of glamour and price.

We see gems as long-term stores of value — you can't go wrong with a diamond. If your life goes well, you can flash it on your finger indefinitely. And if it doesn't? Well, what's more portable and liquid in a time of crisis than a handful of gems? They're the smallest physical store of money around.

How much of this is true? In many cases, not much. It is absolutely true that over the long-term, gems have been an excellent store of value, in that they have provided a valid hedge against inflation and currency fluctuation. Like gold and silver, good gems tend to hold their real value in all currencies and can even provide an alternative to paper currencies. But that doesn't mean that all gems are a good investment — it's a minefield of artificial stone treatments, manipulated prices and various pricing structures that are far from transparent, just waiting to blow up amateur investors.

Diamonds: common as muck...

Take diamonds. Think they're scarce? Think again. A quick look around at a few of the ring fingers nearest to you should be enough to reassure you that diamonds are far from scarce. If there is at least one on the hand of every engaged and married woman you've ever met, where's the scarcity? There isn't any. You just think there is because that's what the diamond industry, which has been tightly controlled by De Beers since the 1920s, wants you to think.

In fact, diamonds are plentiful. Some 114 million carats of diamonds are produced every year and, with new mines coming on stream and others being expanded, that should rise to about 120 million in 2005. Given that the average engagement ring contains well under a carat, it's no wonder that there are enough diamonds not only for most of us to own one, but for virtually every modern factory in the world to be stacked with them. And 80% of the diamonds dug out of the ground end up being used in industry. Diamonds are the hardest natural substance on the planet — a perfect ten out of ten on the Moh hardness scale - which explains why so many are used as cutting instruments. It also explains why we first started using them in engagement rings. If you're going to wear a ring every day for 40-odd years, it needs to be tough.

So, if diamonds are so common, how did we come to think they were so special? The answer is that, until very recently, De Beers controlled about 80% of the world's supply, so during downturns in demand it would be able to regulate supply and stockpile them to keep prices high. This was backed up by the creation of demand. Catch-phrases such as "Diamonds are Forever" and adverts insisting men spend three months' salary on a ring for their fiancée created the myth that diamonds are a scarce, valuable resource. And then DeBeers controlled distribution to keep it that way.

The good news is that there are now a number of challenges to the dominance of DeBeers in the diamond market, which has brought transparency to the market. The bad news is that diamonds are now being treated more as the commodity they are, and prices will not be as stable in future as they have been in the past. Rough-diamond prices have risen in the last year, on the back of Chinese demand, up 22% last year, but not all analysts are convinced this will last. There is, according to industry consultants Tacy Ltd, currently a large supply overhang of rough diamonds, which should keep prices down.

Only buy very special diamonds

None of this means diamonds are a no-no as an investment. Large or well-colored ones will hold their long-term value: right now, prices of rare red and green, fancy diamonds are soaring. But, if you do buy, make sure there's something special about your diamond, that you know its provenance, and get it from a reputable dealer or auction house. Whatever you do, don't buy retail. You'll pay a mark-up of 500%-plus.

Pearls: gems you can trust

Even if there are a few good diamonds around, a better bet for long-term value might be pearls, says Virginia Blackburn in *The Times*. According to jewelry dealer Sheldon Shapirom, about 99% of the pearls he sees are cultivated, "which means the rarity value of real pearls makes them very valuable indeed". If you see them, buy them and keep them.

Emeralds: gems you cannot trust

First mined in Egypt since at least 330BC, the number of fine-quality emeralds around is limited. That means that a large percentage of the gems available on the market have always been treated to improve their clarity. However, in the late-1980s, emerald producers started to inject the gems with resins to fill any cracks. Today, the market is still considered untrustworthy and not one to invest in, says *The Telegraph*.

Real money in rubies and sapphires

Rubies and sapphires, which measure nine on the Moh scale, are both varieties of the same mineral - Corundum - but develop different colors, depending on the chemicals in the rock. However, they all score highly as an investment because of their relative scarcity. The major sources for rubies are Afghanistan, Kenya, Sri Lanka, Tanzania, Thailand, Vietnam and Burma. The best come from Burma, but many mines are now worked out and political instability has disrupted supply. Similarly, the best sapphires used to be found in Kashmir, but supply came to an end in 1925. All this means that good stones hold their value very well. Note, for example, that an untreated Kashmir sapphire ring is going on sale at Bonhams jewelry auction next week. It was bought about 17 years ago for just over $32k and its auction estimate is now $114.9k to $153.2k.

Tanzanites: very rare indeed

Tanzanites, which are a vivid blue in color, were discovered in 1967 in the foothills of Mount Kilimanjaro and are a thousand times more rare than diamonds, says Kate Reardon in *The Times*. The supply is still limited to just a 5km strip of land near the mountain and prices can be volatile. But given how few tanzanites there are around, they make an excellent investment.

Buying is fraught with danger

So you should buy rubies, sapphires tanzanites and special diamonds, but how? There are pitfalls. Not only are many on the market fake, but you need a huge knowledge base to invest well. The cheapest place to buy gems is from merchants in producer areas, such as Thailand, but many amateur investors who brave the market there can end up being fleeced. However, there is no point buying retail in the West. Just as a new car loses 20% of its value as you drive it out of the showroom, so a ring bought new in a jewelry shop falls in value as you pop it on your finger. Retail mark-ups start at about 300% and rise from there.

This suggests that the best and safest way to invest in gems is to buy vintage jewelry, the average price of which has risen by about 4% a year in the past 18 years, according to Art Market Research. In the past, jewelry was bought mainly for its gem content, says James Sherwood in *The Independent*, and that's still the case. With vintage jewelry, you can usually be pretty sure that a gem has not been treated and you should also end up paying a fair price for it. There is, for example, a 1.92 carat colored, diamond Tiffany ring about to come up for auction at Bonhams. The estimate on it is $15.3k – $19.15k. A similar ring, with only a 1-carat stone, would cost you $45.96k new.

However, investors are looking just as much for design and craftsmanship today. About 100 years ago, the craftsman's time was not as valuable as it is now, and that means they used to spend a great deal longer working on each piece than is generally the case today. The provenance of jewels from old master jewel-houses, such as Boucheron, Chaumet, Cartier, Van Cleef & Arpels and, of course, Fabergé, greatly increases the value of the piece. And, even if it doesn't, you'll still have a beautiful piece to wear. All the major auction houses, including Bonhams, Sotheby's and Christies, have regular auctions of gemstones and jewelry. All have experts who will talk you through the pieces in the auction, allow you to view them and be able to provide you with detailed information — with the assurance that experts have authenticated each piece. The viewing and the bidding take time and effort, but it should be worth it.

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Investing in Energy

***Is the oil industry the single best investment you can make?
Yes, says Bill Sarubbi***

When we think of bull markets, we tend to think of them as a strong upwards movement in all stocks in a given market — as was the case from 1982-2000. But long-term bull markets can also exist within one specific group and sector, and it rather looks to me as if that is exactly what is happening in the energy sector. It has now been rallying for a few years, but I fully expect it to continue to do so for a good few years to come. Why? For two reasons. The first is inflation and the second is the very strong long-term supply and demand situation in the oil market.

Inflation is back

Inflation is a red flag for a commodities bull of any kind. If we think of inflation very simply as the excess creation of money (via credit) over and above the demand for money, this makes sense. When you first introduce excess cash into the economy via the credit system (by having low interest rates that encourage people to borrow) economies and markets are spurred on. But go too far and things can go wrong: once all the available means of production have been drawn into play, the excess money looks for new places to go. That's when you find things such as stocks, land and commodities suddenly seeing their prices soaring for no fundamental reason.

This is the situation that the U.S. now finds itself in. The Federal Reserve's loose money policies have created debt — and, of course, the interest payments that go with it. Today in the U.S., debt as a percentage of GDP is at a record high: that means that the Fed can't raise interest rates fast — that could easily lead to a string of bankruptcies. The upshot? The Fed has no choice but to keep on inflating. That in turn means there is excess cash knocking about all over the economy, which leaves us with just one question: where is it going to go?

The answer, I think, is commodities. Over the last few decades, there has been a good correlation between the rise in the national debt — or money supply — and the stock market. From 1980 to the mid-1990s, the debt rose by fivefold. The Dow also rose by five times. Yet over the same time period, the price of most commodities has fallen: they've got a lot of catching up to do, as they have to make up for over two decades.

In 1980 the oil price was \$25-\$35 a barrel. So given the increase in money supply, \$50 hardly seems a high price. Indeed, \$50-\$60 should now probably be considered as more of a base for the oil price than anything else. Don't forget that in inflation-adjusted terms, energy is still pretty cheap: bottled water is, for example, still more expensive than oil in most places around the world.

The supply of oil is very tight

For some time now, there have been rumors around that oil production in Saudi Arabia has peaked. Consider this: Pumping water into wells tends to reduce the life expectancy of a well, but it is also a quick way to bring oil to the surface, and one that the Saudis appear to have been taking advantage of. The largest Saudi field is now showing a 55% water cut (i.e., 55% of what comes to the surface is the water that was pumped in to force the oil out). Experience has shown that a field collapses when this ratio hits 75%, so the situation looks relatively serious.

Note too that it may not just be Saudi Arabia where oil production is peaking: according to many, global production as a whole will peak by 2010. And don't forget that there is also a high level of political risk in Saudi Arabia, where the rulers have consistently made the mistake of not spreading around the lucrative returns from oil quite enough. That means that the Saudi royal family faces considerable opposition: instability could pinch production at some point.

Another major problem with oil is one that Jim Rogers recently pointed to in *Barron's*: no one invests in the means of production when they are unlikely to recoup the investment. The price of oil fell by about 66% from 1980-1999, so people stopped looking for it. Why bother drilling for oil when it only fetches $10 per barrel?

During the 1990s, most investment capital chased higher returns in the technology sector instead.

The result, predictably, has been that new sources of oil have not been discovered and older, cheaper sources have been overexploited. Production in the North Sea and Australia has already peaked, for example. To find new sources there must be investment in exploration and drilling — and it is only with the recent higher prices this has become financially feasible.

Investment in infrastructure has also faltered worldwide. In the United States, no new refineries have been constructed for more than 20 years. Add to this the fact that Russian, Iraqi, Nigerian and Venezuelan production have all stalled at some point in the last few years and you begin to understand why the price of oil is heading up: it will take some time to bring more capacity on line, thus leaving supply trailing demand for years to come.

Too many people want oil

A recent study by Legg Mason tells us all we need to know about the demand for oil. If you assume that everyone living on the east coast of China (where a third of the 1.3 billion population live) and in Indonesia starts to consume the same amount of oil as the Japanese did at the same stage of industrial growth, then the world needs a daily oil supply equal to two Saudi Arabias every day. China's oil consumption has grown by somewhere between 7% and 15% annually — depending on which numbers you use. Indonesia's demand has been rising by 10%, while Mexico, Vietnam, India, Turkey and Thailand are also seeing consumption rise at a high rate. OPEC nations are consuming an increasing percentage of their own production — leaving less and less oil available for exporting.

The technicals look good too

Having established that the fundamentals of a market look good, it is always useful then to look at the technical position and see what that is telling us. First look at market capitalization. In 1980, energy companies made up 28% of the S&P 500's market capitalization. They then collapsed. In 2000, the technology stocks were 30% of the S&P. Again they then collapsed. Today, energy stocks make up about 8% of the S&P — a level usually seen by a sector that is near its nadir — as tech was in 1990. That rather suggests that the only way is up — regardless of the sector's renaissance so far.

So how long can this bull market last? The energy group is now emerging from a 22-year bear market. Compare this to the food group's bull market. This group consolidated in a huge rectangle for 25 years and broke out in 1980. Foods then outperformed for the next 13 years. There is a good rule of thumb one can use to measure the subsequent upwards move after a nasty bear market: multiply the length of the bad times in the sector in years by 0.6 times 25, equals 15 years — so pretty close! Looking at the energy group, 0.6 times 22 suggests 13 years of out-performance. That tells me that longer-term, investors can consider putting their money in energy stocks.

One other thing worth looking at for reassurance that this bull market has barely begun is the wellhead price of oil. This is the cash price paid at the wellhead, a figure that has been recorded for the last 137 years and which can give us a clear idea of how the price of oil tends to move when it turns. It moves a lot: the last three major upswings have resulted in the wellhead price rising over 450%.

Finally, I want to point to market sentiment. Most fortunes are made by those who have measured what the market thinks and then adopted a contrary position. In the oil market, I would say that the opinion and spending habits of the Arabs provide a perfect contrary opinion indicator: they have consistently forecast oil and gas prices on the low side. So what are they doing now? The answer is that they are aggressively cutting costs — they just don't believe that prices will stay high. I recently asked one Abu Dhabi official if they planned to raise the official price they use when trying to figure out whether future capital spending projects in the oil industry would be worthwhile. He said not: they had considered moving the price to $25, but they then decided to leave it at $18 per barrel — a level that seemed to them to be more likely. And this when oil prices are already above $50!

Add all this up and it seems pretty clear to me that every sensible investor should be holding oil stocks. And if you aren't already, note that March is historically the best month of the year for holding oil stocks. Over the last 22 years, the sector has outperformed the S&P 77% of the time in March and April.

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The best oil companies to invest in — in the U.S. and the U.K.

If you want to get into oil, look no further than our two majors, BP and Shell. Historically they have tended to move in tandem, so if you are in for the longer term, it really doesn't matter which one you go for.

The question is not which is better, but are they both still a buy? And the answer to that is a firm "Yes."

Higher oil prices look like they're here to stay, yet while BP and Shell have made back most of the ground they lost when their share prices fell in 2002, there is little evidence they have yet adjusted for today's oil price of $53. In fact, Shell hasn't traded on such a low P/E since the late 1980s, when double-digit interest rates forced all equities into the cheap zone. Up until 2001, Shell's earnings yield was always higher than the yield on gilts.

Ten-year gilt yields are now 4.5%, suggesting Shell should be on a p/e of over 20 times (1/4.5 = 22 times) instead of its current 11.12 times. There is an equally compelling case to be made for BP. Since last autumn, consensus analyst medium-term profit forecasts for the firm are up around 43%. Yet technically speaking, BP has been in a downtrend now since the all-time high way back in 2000. This is despite the fact that analysts are 20% more bullish on BP's profit outlook now than they were even at their most optimistic at the peak of the last cycle.

Outside the majors, investors should be more cautious — note that many of the more speculative stocks that call themselves exploration and production companies are often no more than cash shells. Worth considering, however, might be Gulf Keystone Petrol (AIM, GKP), says the *Investors Chronicle* — the firms exploration program in Algeria is going well and "the shares look good value." Otherwise, consider Sterling Energy. "The shares trade on a multiple of four times 2006 cash flow," says R*ed Hot Penny Shares*, "which is attractive."

In the U.S., we are probably better off avoiding the larger companies. They have been lagging the wider sector since 2000. Each of the following four firms are involved in a fast-growing segment of the energy patch and are classified as either mid or small cap.

Atwood Oceanics, Inc. (ATW) is engaged in the international offshore drilling of exploration and developmental oil and gas wells in offshore areas and related support, management and consulting services. During its 36-year history, the majority of the company's drilling units have operated outside of United States waters. It has conducted drilling operations in most of the major offshore exploration areas of the world. The stock has moved a long way since we first began recommending it in 2003, as we can see in the chart. But we expect it to continue to do very well. On a fundamental level, the firm should benefit because sea drilling is profitable with oil over $35 a barrel, a level unlikely to be seen again soon. But at the same time the technical position looks good. The shares have only recently ascended from a huge multi-year base and this is the type of technical launching platform that leads to longer-term out-performance.

Transocean Inc. (RIG) provides offshore contract drilling services for oil and gas wells, related equipment and work crews, to drill oil and gas wells. The firm operates with a particular focus on deepwater and harsh environment drilling services and should, like Atwood, do well out of the fact that sea drilling is now profitable.

The other two shares we would recommend are Cooper Cameron Corporation (CAM), an international manufacturer of oil and gas pressure control equipment and Ensco International Incorporated (ESV), an international offshore contract drilling company.

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Be a Profit Connoisseur

Bubbly returns in the champagne market

Wine investment is not just about the reds: champagne can provide lucrative returns too. But which should you buy?

Discussions about wine investment more often than not focus on red wines. Rarely do they touch on champagne — and perhaps for good reason. Champagne, not unlike smoked salmon, used to be a luxury item. These days, it's commonplace: supermarket price discounting has devalued the product. This is not necessarily bad news. Increased accessibility has seen demand explode from 50 million bottles in the 1970s to just under 300 million today. But champagne producers are now operating at close to full capacity. So on the assumption the appellation won't be extended (it won't be); demand is soon set to outstrip supply. That could well lead to rising prices for even bog-standard, non-vintage labels.

Increased champagne consumption is also good news for the premium-vintage champagnes — as tastes develop and incomes allow it, buyers move up the value curve. This effect is best illustrated by Louis Roederer's premium-vintage Cuvée Cristal. The favorite tipple of every gangster rapper and footballer's wife, demand for this wine has been extraordinary over the last few years. In a comparison between the three biggest brands in the game — Krug, Dom Perignon and Louis Roederer Cristal — and three of Cristal's most recent vintages, all the top marques produced steady returns. But Cristal is the consistent out-performer. This is partly due to the "bling" factor, which has driven demand since the millennium, but the real cause of the out-performance is lack of supply.

Many other premium champagnes, including Krug and Dom Perignon, regularly enjoy more critical acclaim, but only about 25,000 cases of Cristal are made. That is much fewer than Krug and Dom Perignon. Furthermore, the make up of Cristal's customer base means that it is being consumed early rather than put in the cellar. As a result, stocks quickly dry up in the secondary market. We haven't seen a full case of 1995 on the market, for example, for six months now.

It is not just its peers in champagne that Cristal has outperformed in recent years. Since its release, Cristal 1996 has trounced our blue-chip index by an impressive 50%.

For the purists, an alternative to getting involved in the racy Cristal market — which can be difficult anyway, given the pace at which it moves — is to buy into the recent "back" vintages of Dom Perignon and Krug — 1985 and 1988, for example. These have barely moved in recent years, but there will be a point before long when supply rapidly dries up. Then prices should rise nicely. Take a look at the prices of some of these 'back' vintages and you'll see a steady price rise as the rarity value kicks in.

Champagne investment, as with all wine investment, requires that one stick to the blue chips, and in this market there are only a handful. This can make investments far less risky than in areas where choice is broader. It also means the impact of scores becomes less relevant. The 1982 Krug, for instance, was last awarded 90 points by *Wine Spectator* (the 1985 got 94, and the 1988 got 98), but its rarity value is already beginning to drive its price upward. The champagne market, more than any other, is driven by demand and supply. Get your timing right, and the returns can be bubbly.

Author Justin Gibbs is director of Liv-ex Ltd.

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Eyeing the art market

Prices in the art market, particularly for contemporary work, just keep on climbing. Is now the time to buy in? Emily Hohler reports.

The art market is red hot at the moment. The question is, are investors going to get their fingers burned? Recent auction sales, along with the sheer number of price records being set (16 last month in New York alone), are inviting comparisons with May 1990, six months before the art market crashed. Contemporary auctions at Sotheby's and Christie's in New York last month generated $220m, while Sotheby's Impressionist and modern art sale raised $194m. Some of the recent price rises have been astonishing. A painting by Kees van Dongen, which sold for just under $153k in London in 1997, fetched nearly $6m in New York last month.

According to the Art Market Research company, prices for the top 25% of contemporary art have accelerated in the past two to three years following an almost unbroken pattern since 1996 of rising prices. Works by artists such as Peter Doig and Marlene Dumas, which you could have bought for tens of thousands of dollars around five years ago, are selling for hundreds of thousands. For the first time last year, prices for work by living artists exceeding $1m breached 10% of all art works sold at auction: Artprice recorded 328 bids over $1m, compared to just 210 last year.

The boom isn't limited to contemporary art, although the move here has been most dramatic. A survey by *ARTnews* found the majority of leading global collectors favor contemporary art over modern and Impressionist by ratios of two and four to one respectively, which is translating into prices. Nor is the excitement confined to the very top of the market. Dealers at this month's art fair in Miami were selling out on the first day, while at Frieze Art Fair in London this October, private collectors spent nearly $50m in one weekend.

The day after, Damien Hirst's Pharmacy sale at Sotheby's raised over $21m. This would suggest that while collecting remains a rich man's game, there appears to be no shortage of big spenders. The statistics back this up. The ranks of high-net-worth individuals — defined as those with $1m or more in financial assets, excluding real estate — in the U.S. rose 14% to 2.27 million last year, while the number in Europe rose by 2.4%, according to the latest Merrill Lynch/ Capgemini world wealth report. Given stock market turbulence over the past five years, it's not surprising these individuals are starting to look for places to put their money aside from stocks, bonds and cash. Art, unlike other investments, has an advantage over other hard assets because it can be enjoyed and confers status — so called "wall power" — on its owner. Art is also increasingly viewed as a good way to diversify a portfolio, because although prices appear to move independently of stocks, long term they perform at least as well.

The evidence for this comes from the Mei/Moses All Art Index, devised by two professors from New York's Stern School of Business. The index is based on the resale values of paintings at auction in New York and currently captures 75% of fine art sales, (rising to 95% next January when it will include postwar and contemporary art sales).

It reveals that while the correlation between the art market and Wall Street between 1953 and 2003 is low (just 0.04%), in that period the art market performed slightly better than equities, producing a compounded 12.06% annually between 1953 and 2003, compared to S&P 500 returns of 11.65%.

But good long-term prospects do not mean that now is a good time to buy. If history is to repeat itself, a crash could be on the cards. The last art-market boom of the 1980s, fuelled mostly by Japanese and American corporations, went along with the bull market in stocks, but its crash came in 1990, three years after Black Monday in 1987. The current boom, which has been largely driven by private collectors, has remained strong in the aftermath of the dotcom bust in 2000, aside from a temporary blip after September 11th, as the world's excess liquidity has searched for a new home. But what might trigger a crash? Falling property prices that domino into falling consumption and discretionary spending, perhaps. According to James Goodwin in the *FT*, there have been reports from Australia showing that house-price falls in the first half of the year coincided with falls in prices paid for modern and contemporary art. If property prices fall in the West, then art prices could follow. This meets with the idea that the art market is currently experiencing the latest bubble in a series of bubbles — which started with bonds and equities and has since shifted into property, commodities and art of every kind.

"There is no doubt that we are in a bubble," says Anders Pettersen, market analyst and founder of Arttactic.com, "but exactly where we are in it is another matter." Although dealers haven't yet stopped buying (when they do, it will be a real danger sign), what concerns Pettersen is the "gold rush feeling" in the art market at the moment. "There are a lot of wealthy individuals out there who are looking for an alternative asset class and have noticed a lot of headlines in the media about astonishing returns to be made in the art market. These are not the discriminating connoisseurs of old but people who want to make money." Yet there are only so many contemporary artists who will stay the course, and today's "hot" artists are already beyond the reach of most people.

Pettersen counsels caution. Investors should wait until the next big round of sales in February and the Armory Show in New York in March to see what is happening to prices. And if you do want to invest, he advises, go for the lower end of the market. The Mei/Moses index suggests that, over the long-term, lower-priced pieces appreciate faster while masterpieces tend to under perform the market as a whole. Not everyone agrees with the gloomy prediction. As Tobias Meyer, worldwide head of contemporary art at Sotheby's points out to Carol Vogel in *The New York Times*, back in 1910 collectors were buying Gainsboroughs at what then seemed like astronomical prices. "The same thing is happening now for 20th-century art." In another 100 years the prices we are paying now might seem cheap, says Meyer.

That's not a bad point, but it assumes that everyone investing is doing so for the very long term, and therefore has little interest in what price they pay today. That's not very likely. As Thomas Sutcliffe says in *The Independent*, "sometimes it's just not a good time to buy… and unless you believe that prices will rise in perpetuity, with no future correction to the market, you might conclude that having your acquisitive instincts curbed by penury could be a blessing in disguise. If you really want a Hirst, wait for another 20 years when you may well find he's surprisingly affordable compared to today's prices."

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Prowling for Profits

Look before you leap into New Europe

Today's estate agents love Eastern Europe. With tourists flocking to the region and its astounding beaches, more of us are being won over to the idea of buying into the blossoming housing market, either as investments or second homes.

After all, who can resist the idea of owning a castle in Poland for a mere $57k or a mountainside chalet in Bulgaria for just $11k. But is investing in the area really wise?

The reality is that investing in Eastern Europe may not be all it's cracked up to be. For starters, there is a growing fear that the rampant building of new homes and apartments in the region will end up depressing rental returns and capital gains. Then there are problems with the infrastructure, or lack of it, while complicated regulations and lack of financial transparency make buying a minefield for the unwary, says Simon Conn of overseas mortgage specialist Conti Financial Services in *The Observer*. Here are some of the pitfalls country by country.

Croatia

Croatia has gained a reputation as being what the Mediterranean once was. Its coastline, historic buildings and islands draw buyers from all over the world. But it isn't cheap anymore: a few years ago, when the market began to open up, seaside villas could be snapped up for a few thousand — but now, small concrete bungalows by the sea cost much the same as they would in the U.S. Worse, says Conn, there is no legal organization regulating home ownership and Croatia's disorganized Land Registry system often means that the owner of a house is not actually the person selling the property.

Bulgaria

Looking at the prices of homes in Bulgaria, the temptation to take a punt is huge. The prices are staggeringly low: skiing cottages can be had for less than $11k (or thereabouts — the currency is so volatile that prices are mainly listed in the local currency and change often). But that may be for a reason. In Bulgaria, individuals are able to buy either buildings or land: if you want to buy both, you must be a registered company. And setting up a firm in Bulgaria is not an easy business. Moreover, the actual price that a buyer will end up paying may not correspond to the price that appears on the title deeds, as the deeds will carry a 'tax estimation' price well below the final purchase price. Finally, note that Bulgaria has been building huge numbers of low-cost resort apartments that are rapidly driving down prices, says Graham Norwood in *The Independent*.

Montenegro

With its amazing fjords and mountains, Montenegro has been fast attracting foreign investors, especially since it changed its currency to the euro in 2002.

This ought to give some comfort to investors, but if so, it's more than reflected in the prices. Considering their lousy economy, Montenegrans are asking pretty punchy prices for their houses. A two-bedroom house on the edge of one of the fjords can cost e220k (or $291k). And if that sounds OK to you, note that ownership issues abound. Property is owned freehold, but land is owned in leasehold. This can get very confusing and often leads to disputes. Second, surveys are rarely done in Montenegro. If you buy, make sure you get one done independently, says Conn.

Poland

The romance of buying a castle in Poland for under $19k, even if it does need substantial renovations, has a very strong appeal. Unfortunately, once you had spent $1m plus restoring it, there is always the worry that a displaced Jewish family, or their relations, will turn up one day to — perfectly legally — reclaim the property. Poland is also suffering from too much communication between estate agents, developers, local banks and lawyers. A buyer may think their joint knowledge of the law and their ability to speak the language is helpful. Not so. Instead, says Conn, their tendency to work together means that not only can buyers fail to get the best mortgage rates, but there are sometimes even doubts over the legal validity of transactions.

The Czech Republic

If you are adamant about buying in Eastern Europe, your best bet may be the Czech Republic, says Norwood in *The Independent*. However, while many of the problems evident in other countries do not apply here, there are still pitfalls to watch out for. Buildings and the land on which they are built are often owned by separate people, for example, and while the seller of a property is responsible for a property transfer tax of 3%, should he not pay up, it becomes the burden of the buyer. You'll also need to pay nearly $3k in order to set up the limited company needed to purchase a property.

So how can you avoid all the traps of investing in eastern Europe? You should get an independent, diligent, reliable lawyer who speaks the language. The old mantra remains crucial when buying in the region: always take independent advice, says Conn.

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Making profits in a fantasy world

An Australian has just bought a virtual island for $26,500 as part of a "massively multiplayer online role-playing game." What on earth is he getting for his money? asks Simon Wilson.

What is an MMPORPG?

"Massively multiplayer online role-playing games" are communal games that can have hundreds of thousands of players — strangers to each other offline — taking part over the Internet. Globally, there are now about 350 MMPORPGs, with dozens of games having more than 100,000 registered subscribers. The most popular are quest-type fantasy or sci-fi games, in which the aim is to become the most wealthy or powerful character in your particular fantasy world. Some think that these games represent the next big thing, not simply for the computer games industry, but also for the Internet as a whole.

How does an MMPORPG differ from a traditional game?

Role-playing games took off in the late 1960s with the huge popularity of Dungeons and Dragons. This was initially a board game, but appeared in computerized form for die-hard fans in the early 1970s. It was followed by the likes of Adventure and Zork and online games have been developing fast ever since mass-access to the Internet took off in the early 1990s. The key to what's different about the new generation of games, however, is the phrase "massively multiplayer." Rather than just a few people playing against each other, high-speed broadband internet (the craze started in Asia, and in particular Korea, where 75% of households have broadband access) and the power of modern PCs has made it possible for vast global communities all to play games such as Everquest or Star Wars Galaxies at once. The other thing that is different is the scale and complexity of the artificial worlds the role-players inhabit — it's all a far cry from playing Donkey Kong on a ZX Spectrum 20 years ago.

So what's this about buying an island?

Some types of game have their own "economies," and allow players to convert real money into a special currency for the purposes of the game. Almost inevitably, these synthetic economies sometimes spill over into the real world. For example, characters, skills and assets in popular games such as Dark Age of Camelot and Ultima Online are traded, often for hefty sums, on auction sites such as eBay (although the biggest games maker, Electronic Arts, has taken legal action to stop players selling its virtual property in the real world). Then, just before Christmas, a 22-year-old Australian known only by his in-game "avatar" of Deathifier, spent $26.5k on a virtual island that only exists within the world of a game called Project Entropia.

In this game, which uses a fixed exchange rate of ten Project Entropia dollars to $1 USD, 200,000 role-players are currently battling to colonies a new planet called Calypso. According to the publishers, the quest will take you on an "epic journey into the future" during which "you must learn to use all available resources and a growing multitude of skills, wits, guts, teamwork and equipment to reclaim a lost paradise."

Why buy something that doesn't exist?

Paying $26k for an imaginary island certainly looks like the act of an internet-obsessed nut with more money than sense. But, in fact, Deathifier has made a calculated investment decision in the same way as he might in the real world. Potentially, he stands to make a decent profit from fellow 'colonists' in Project Entropia by selling forestry and hunting rights, as well as letting out parcels of land on which other people can build houses. All these opportunities might be "imaginary", but the land sales alone are potentially worth 300k Project Entropia dollars — or $30k real ones. Thus, according to the people who play the game, it is perfectly possible to make sizeable sums of money by playing the game. But be careful: the amount of money in the Project Entropia economy is fixed, so for every winner there's a loser.

How do the games companies make money?

Project Entropia is free to join and play. The publisher, U.S.-based MindArk Software, is planning to allow real-life companies to advertise within the world of the game, and presumably seeks to make investment returns on the cash hoard that players must in effect lend the firm interest-free for long periods. However, most games operate according to a more conventional model. The user buys the setup software and then pays a subscription to participate — starting at around $10 a month.

So it's a cash cow for games publishers?

Not yet, but there are some star performers worth investigating, such as Shanda Networks, China's hottest Internet IPO of 2004. Shanda draws three-quarters of its revenue from MMPORPGs, and is listed on Nasdaq as an American Depository Share, soaring since being listed last year. But generally, publishers are still experimenting. Online game playing cuts out the traditional game-console producers and retailers, for example, so for publishers who get it right — in terms of content and payment method — the gains could be huge.

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Star Wars

Virgin aims to take paying customers on trips in space within three years. Some say that's an optimistic proposition. But Virgin isn't the only one having a go. Simon Wilson reports.

Have any tourists entered space?

It's early days. Only one company, Space Adventures — formed in 1997 and based in Arlington, Virginia — has actually sent paying customers into space. In 2002, they arranged for Dennis Tito, a former NASA scientist turned businessman, and Mark Shuttleworth, a South African internet tycoon, to go on ten-day trips to the International Space Station, courtesy of spare seats on Russian rockets. It cost the two space tourists $20m each.

So why all the excitement?

In October, a small Californian company called Scales Composites — led by a renowned designer of experimental aircraft, Burt Rutan, and backed by Microsoft billionaire Paul Allen — sent the same manned spaceship to an altitude of 100km (the limit of the earth's atmosphere and thus the distance regarded by geophysicists as the start of "space") twice in a two-week period, a feat that has defeated even Nasa. As owners of the first private company to manage this, Rutan and Allen won the $10m Ansari X prize — an open competition aimed at fostering private space travel. Their reusable craft, called SpaceShipOne, was launched at high altitude from a carrier airplane ("White Knight") and returned to a landing strip in the Mojave Desert in California.

What's different about SpaceShipOne?

Apart from the novel launch method, its crucial innovation — which tackles head on the trickiest bit of manned space flight: getting the people back to earth — is its hinged wings. At the highest point in the ship's flight, the wings hinge up, creating a feathering effect so that it then glides back down to Earth. In addition, thanks to an innovative design that uses synthetic rubber and nitrous oxide as fuel, the rocket booster is less likely to explode than conventional liquid fuel rocket engines.

So is this the start of mass space tourism?

It certainly brings commercial space flights a huge step closer. SpaceShipOne is "sub orbital" — meaning that it will ascend to 100km and then dip into space for a few minutes rather than orbit the Earth. Even so, it allows passengers to experience weightlessness and the extraordinary views of Earth you get from space.

As a result of its success, the once-fanciful idea of taking ordinary people into space for profit looks credible for the first time. Days before the prize-winning flights, Virgin founder Richard Branson announced a deal with Allen and Rutan. The aim? To provide regular sub orbital flights into space within a few years. The new firm, Virgin Galactic, is to build a larger version of SpaceShipOne that will take between five and nine people into space for about $200k each.

How soon?

Virgin Galactic aims to have customers in space within three years, and although space-industry analysts think that's optimistic, Branson means business. Virgin has already spent $20m licensing the SpaceShipOne technology from Rutan and Allen, and has a development budget of $100m. Their next big milestone is to finalize the construction contract early this year, after which work will begin on the exterior of the first SpaceShipTwo. There will also be a new "mother" craft to launch the ships into space. The plan is to name the first two ships in the series VSS Enterprise and VSS Voyager, after vessels from TV drama Star Trek; Virgin says that VSS Enterprise should be ready for testing in 2007, with paying customers in space six months later.

Can space tourism possibly be safe?

To date, 18 of the 430 people who have flown into space have died as a result. The designer of SpaceShipOne, Burt Rutan, points out that "you can't have an airline that kills 4% of its passengers" — and has vowed to make the Virgin flights "at least a hundred times" safer than space travel has been to date. Obviously, some degree of risk is inherent in space travel — even sub orbital — a fact that America's Commercial Space Launch Amendments Act 2004, just passed by Congress, acknowledges. The new law says that space tourists must be informed of the risks — but also that they must sign waivers of liability before flying. By providing a regulatory framework that lowers the risks of claims in the event of accidents, the new law should help encourage more entrepreneurs to become involved.

How big is the market?

Nobody knows. But all the market research to date suggests there's more than enough interest to justify Virgin's investment. About 13,000 people have already registered to pay a deposit and some want to pay the full $200k upfront to bag a place on one of the first flights. So overall, given that it only needs to fill 5,000 seats over the first five years to turn a profit, things look reasonably promising for Virgin.

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How to profit from "medical tourism"

What is medical tourism?

Traveling for the good of your health. This isn't new. In ancient Rome, the wealthiest citizens enjoyed restorative breaks in Cyprus, and Alexandria, on the Egyptian coast, was a top destination for Greek medical tourists in the third century BC — attracting people owing to its climate, political stability and reputation as a center of medical excellence. Then, in the 19th century, well-off Britons toured the Continent to take the waters at German spa resorts. Today, rich people from Western and other countries are increasingly traveling great distances to get medical treatment — even surgery. However, they are often doing it not because they can't get the same treatment at home, but because it is cheaper abroad.

What's fuelling modern medical tourism?

The same things that expanded health-related tourism in the 19th century: cheap travel and large numbers of well-off people with excess income. Combined with too-expensive, or hard-to-come-by domestic treatment options, and the information revolution sparked by the internet, this means growing numbers of people are prepared to seek treatment abroad. According to *Martin Spring's On Target* newsletter, medical tourism worldwide is already worth around $40bn a year, and is growing at an annual rate of up to 30%.

What kinds of procedures are we talking about?

Everything from dentistry and hip replacements to IVF, and even open-heart surgery. In Europe, the main direction of travel is from West to East. Germans (and also Americans) have been traveling to Hungary for years for high-quality, low-cost dental work, for example, but since joining the EU, Hungary and Poland have seen a surge in medical tourism. Polish dentists and cosmetic surgeons, and Czech and Polish fertility clinics (prices tend to be around half the German levels) are booming as a result.

And further a field?

Private hospitals in developing countries such as Thailand and India are actively promoting themselves internationally. For example, complex open-heart surgery that would cost up to $150k in the U.S. can be carried out in India's best hospitals for $10k. Even with more routine operations, such as hip replacements, hefty savings can be made: a hip replacement that costs $3k in India costs $39k in the U.S.

Another draw is that some countries have long track records in specialized surgery that is not generally covered by health insurance — sex change operations in Thailand and cosmetic surgery in Argentina or South Africa, for example. In South Africa, several firms offer trips that combine cosmetic surgery with safaris or beach-based holidays.

How do governments feel about this?

They love it, especially in Asia, where the fast-growing sector is a nice little earner. India attracted 150,000 medical tourists last year and a recent report from McKinsey consultant's forecasts that Indian medical tourism will be a $3.83bn business by 2012. Singapore, Malaysia and the Philippines all have small but growing medical-tourism sectors, with government strategies in place to foster growth. But the biggest player of all is Thailand, which attracted one million medical tourists.

Are there opportunities for investors here?

Yes. There are several private hospital groups looking to take advantage of the boom in transnational healthcare listed on Asian stock exchanges. Martin Spring suggests that Bumrungrad Hospital in Bangkok is particularly worthy of investigation. It was the first hospital in Asia to be certified by the U.S.-based Joint Commission on Accreditation of Healthcare Organizations and was recently rated by *Asia Money* magazine to be the best small-cap stock pick in Thailand. Of Bumrungrad's patients, 40% are medical tourists, and the group now has branches in China, the Middle East and in other Southeast Asian countries. The shares trade on a reasonable forecast P/E of 15 times.

Otherwise, in Singapore, where the government has set a target of attracting a million foreign patients by 2012, Raffles Medical Group — which offers tourists products such as a $1k "comprehensive health-screening package", incorporating 25 tests and three nights' accommodation — is worth a look. It has a strong balance sheet, good management and trades on a P/E of 14 times. Finally, Spring points to Parkway Holdings, Singapore's oldest and largest private medicine group.

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The year of the deal starts off with a bang

Mergers and acquisitions (M&A) are back with a bang in 2005. The latest is Procter & Gamble's deal to buy Gillette for $57bn. This caps the biggest four months of takeovers since the days of the tech boom in 2000.

This may be good news: it suggests buyers are seeing good value all over the market. Or it may be bad news, in that it tells us America's big firms can't see much in the way of organic growth on the horizon, so they're buying it in instead. Either way, it seems to be telling us that the many predictions that 2005 would be the year of the deal were right.

But the P&G deal should also remind us of something else. Household goods companies such as Gillette shouldn't be ignored. They might look boring compared to internet firms, but try telling that to Warren Buffett, who one day after the announcement of the deal was sitting on a windfall profit of $300m —his Berkshire Hathaway group is the razor maker's largest shareholder, with 9% of the outstanding shares. Not that he is taking any money off the table. On the contrary, he is promising to spend a further $350m on boosting his stake in the new consumer products behemoth.

"Investing in such a huge firm does makes some sense," says Edward Helmore in *The Observer*. "There have been massive changes in the household goods sector in the last few years. P&G-Gillette is going to be a behemoth of a company: the combined firm will have annual sales of $60.7bn. But it needs this size. In the age of giant retailers, such as Wal-Mart and Tesco, suppliers need all the clout they can get to protect their margins."

Before the deal, P&G was hardly small, reported *The Sunday Times*, but even so, along with its rivals, it has watched its power wane as global retailers demand ever lower prices from suppliers (and get them) and launch "copy-cat products" that eat away at branded sales. Once they were able to hold the supermarkets to ransom, but suppliers have increasingly found the boot is on the other foot. Hence this merger: the bigger the supplier, the more it can fight back.

"This all sounds like bad news for the sector, and to a degree it is. But there is "happier news" for the investor, says Nils Pratley in *The Guardian*. Mature consumer goods companies, such as P&G and Gillette, and even Unilever, are inherently cash generative. If they cut back on advertising, cash comes gushing out, at least for a while. In short, these companies' balance sheets are strong enough for them to go deal crazy. Nobody, for example, would go bust by buying Reckitt Benckiser at its current valuation.

All this, along with the need for size, rather suggests that the P&G-Gillette deal is highly likely to trigger imitations. And as Simon Nixon points out on *Breakingviews.com*, next up could well be Unilever. The Anglo-Dutch group has "long struggled" to keep up with P&G. Now P&G will pull even further ahead, putting pressure on Unilever to come up with a deal of its own, perhaps with Reckitt Benckiser. The P&G deal is unlikely to be the last in this sector in 2005.

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