

## Intelligence Report

### Japan

In the past year we had EWJ which is the iShare MSCI Japan (ETF shares) on our preferred stock list. I will keep it that way for 2006. In 2005 the Nikkei went up about 40%. Now most folks are optimistic about Japan, but some Japanese are not so optimistic. Let's examine what is happening there. Assuming that the recovery will continue to be accompanied by supply-side reforms amounting to a revolution in the way capital is allocated. In this endeavor the government has promised fiscal discipline. In the month of December the Japanese government unveiled its budget for the fiscal year that begins next April: it proposes to cut public spending by 3% and to cut bond issuance for the first time in nine years. Second, the central bank will continue to provide free money for the foreseeable future. That is because it has committed itself not to tighten monetary policy until "core" inflation has turned positive for "a considerable time". For the moment, core inflation has not turned positive. But figures for November or December may turn positive. Count on free money for a good year more, and probably longer. With inflation on the rise, real interest rates would even turn negative. Now let's examine if the stock market is overvalued. It seems to me they are not. To take just one stock market measure, the earnings yield on the Topix index is still a high 5% or so, making shares a far richer buy than bonds (chart 2). As for real property, the rise in prices has indeed returned to central Tokyo and that is now

spreading outwards. But, on average, residential prices are back to levels last seen in the early 1980s, while commercial property prices are where they were before the mid-1970s. In addition ordinary Japanese hold huge liquid assets. This it means that they still think that deflation is here. I think that the stock market as a long way to go in the next 12 months. And if you wish to buy properties go to Japan.

### United States

This year expectation is the Fed will increase short-term interest rates between 4.5% to 4.75%. It could happen soon, but this does not mean that interest rates will remain at the level stated by the Fed. Why? Because if you observe the charts of the 13 week yield and the five year yield you notice that the prices of the bonds is going up and not down. This means that there is still a lot of liquidity in the market. The market being awash in liquidity is reducing the yield on the treasury, short-term and medium-term. Since investors recently are wary of investment in real estate, now the flow of money will be in the stock market (global), gold, and in commodities. You should diversify yourself with stocks in the U.S as well as in Europe, Japan, and emerging markets.

### European Union

There is no exciting news from Europe. With few exceptions unemployment in the three major countries is not declining. Inflation is rising and

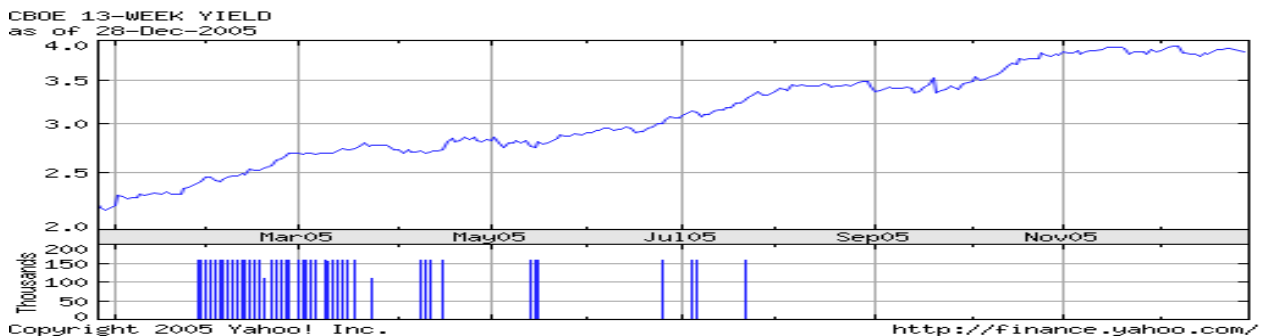
E.U. citizens are struggling. Red tape and fiscal policy of the E.U. members is preventing the economy to grow substantially as it has happened in the U.S., and now in Japan. The European Union policy with few exceptions such as Ireland, in the past ten years, has been bogged down by high taxes and red tape. With all the debts and budget deficit in the U.S. the Euro suppose to be today around \$1.30 to \$1.40, instead is around \$1.18. I express my opinion on the Euro several times in the past three years. I remain that in the short-term the currency will stay on the actual trade range of \$1.17 to \$1.20 per Euro. Eventually the Euro will rise to \$1.30 to \$1.35 in 2006. If this will not occur within the next six months, then I believe the Euro will decline against the dollar to \$1.10. My model global portfolio is now between 40% to 50% in US dollar, 20% to 25% in CAN dollar, around 15% in AUS dollar and the rest in Euro and British Pounds.

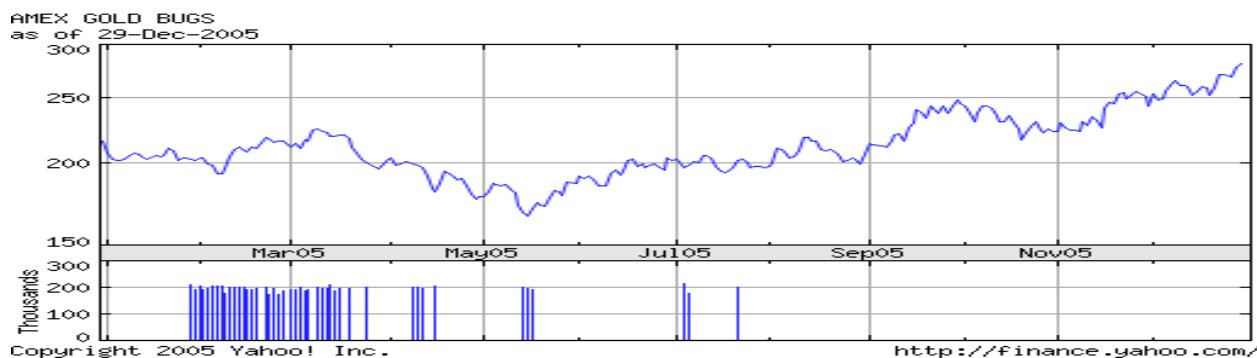
## Gold

As correctly predicted on my Newsletter of January 2005, gold went from around \$430 per ounce to around \$510 at year end. Now the market is very bullish and we could have a short-term reduction in gold prices. Long-term I remain bullish on gold and predicting \$550 to \$600 by year end 2006. One of the main reasons is that production of gold does not satisfy demand. Moreover, Central Banks are not selling gold as they did in the past, and some of them are buying gold.

## The Stock Market

Most of the major indices have not performed well in 2005. The BTK index (Amex Biotechnology) has outperformed the S&P500 and the NASDAQ composite. Investing in life sciences has paid off. Our model portfolio remains invested between 40% to 50% in health care companies, between 10 and 20% in REIT's and the remaining 30% to 40% in various energy and ETF stocks.





## Preferred stock list

**Life Sciences:** ABC\*, ABT\*, ABGX\*, ADS (Adaltis - the Toronto Stock Exchange), AXCA, ARQL, ASTM, BAY\*, BEC\*,BDY\*, BIO\* BIPH.OB, BMET\* BRL\*, CEGE\*, CRL\*, CYT.TO, FLML\*, DSCO, HAE\*, KND\*, MCK\*, MLNM\*, NTY\*, NicOX (Nouveau Marche' France), NBIX\*, NTEC, NTB (Neptune - Toronto Venture Exchange) NUTR\*, NVO, NVS\* OCR\*, PPD1\*, QLTI\*, RMD\*, SHPGY\* SYT\*, USNA\* WPI\* XRAY\*.

**REIT:** ARE, EQR\*, GLB, HCP\*, HCN, IGR, HMT\*, HR, KIM\*, PCL\*, TCO\*, TRC, PSA.

**Gold:** GFI\*, GLG\*, GOLD\*, NEM\* FOR (Toronto Stock Exchange).

## Energy & Others

ATG\*, CHK\*, CMI\*, COP\*, HBC\*, MOT\*, TAP\*, TSO\*, MMM\*, MKC\* UNFI\*.

### Our preferred list of ETF, open and closed funds:

BGRFX, EMF, EWJ, GLD, PBW, RYSEX, TAREX, VGENX, VHGX, VSEQX, VGSTX, XLE, XLU.

\* Shares with options.

**Indexes:** DJI 10,717.60- NASDAQ 2,205.32- S&P500 1,248.29- Amex BTK 680.91- Russell2000 673.22- 10-Year Treasury Bond 43.95- U.K. FTSE100 5,528.10 - Amex Gold 276.90

**\$-Euro 1.1843- \$-Yen 117.74- \$-CAN 86.07- \$ - AUD 73.18**

*Dario A. Bianchi*

**Happy New Year**

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