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Overview

The International Monetary Fund's latest World Economic Outlook, recently published explores the implications of the petrodollars for the world's current-account imbalances. Thanks to higher prices and increased production, the revenues of oil exporters—members of the OPEC, plus Russia and Norway and a few others—reached almost \$800 billion in 2005. Adjusted for inflation, this beats the previous peak in 1980; and in the past three years real oil revenues have risen by almost twice as much as in 1973-76 or 1978-81. Now let's see why price of oil and gas has declined in the past thirty days. Let's remember the largest producer of oil is Aramco which is the Saudi government own company. Second the other big player is Russia. I believe that this is a timely price manipulation by the Saudi government and other OPEC countries. Why? Because calculation by experts in this areas sustain that the price of \$70 or \$75 per barrel were made of about 10% pure financial speculations and another 15% by the cartel. Therefore, the "real" price of crude should be around \$55 to \$60 per barrel. The Saudi are not only the largest producer of oil in the planet but are one of the most sophisticated financial traders. Their investments span the globe. Now let's see in the next six months if I am right about the "real" price of oil. Of course no one know exactly what will happen, but four things we can predict: a) The financial manipulation of the price of energy will continue making the Saudis and other smart

speculators more rich. b) The turmoil in the Middle East is here to say for the foreseeable future. c) The West will take long time to achieve alternative energy output. d) China and India will not slow down too much. Despite the \$5 billion lost from a "high roller" manager of an edge fund two weeks ago, in this scenario I am slightly bullish on oil and gas. Thanks to the idiocy of certain money managers and their respective sophisticated bosses, from time to time financial disasters occur and one day it will succeed the big bang.

China

What must be understood is that China now is moving from an economic problem to a socio-political one. The financial problem is a symptom; the fundamental problem is that what has been built into the Chinese economy is one of the most irrational financial models ever existed. Enterprises that are not economically viable continue to function through infusions of cash. This is for social purposes. Some of the cash comes from borrowing, some by exporting at economically unsustainable prices. The result is a squandering of resources. The reasons that this continues have nothing to do with economic rationalism and everything to do with political and social reality. If interest rates were to rise and lending was to become disciplined, many of China's enterprises would fail. This would bring several consequences. First, and most important, it would result in a massive increase in unemployment. Moreover, we shall never forget that

now in China there is an excess of manufacturing capacity. At this point, the irrationality has been going on for years. It is not only state-owned enterprises that are economically unsustainable; many newer enterprises, including those in which Western companies have invested, are not succeeding. As in the past I wrote on my previous newsletter when we look at the figures for nonperforming and troubled loans, they amount to nearly half of China's gross domestic product. That represents a lot of irrationality, a lot of financial failures and a lot of unemployment. And unemployment is a political and social problem. The question is whether China politically can afford the economic solution. Stay tune, technological innovation will disrupt the Chinese government grip on power, reform the economy, and free one billion people creativity.

Currencies:

The yen in the past thirty days was initially stronger and in the past two weeks in the Tokyo session following the release of Japanese economic data, pushing the dollar between 116.50 and 118 level. Meanwhile, in the past month carry trades continue to cap yen strength against the dollar with the euro/yen pair hitting an all-time high at the psychologically key 150-level and the sterling/yen climbing to a near 8-year high above the 222-mark. The primary driver of the move rests in the uncertainty over the timing of the Bank of Japan's tightening campaign. In light of recent Japanese economic data, particularly the softer inflation data and the prospect of further Bank of Japan rate hikes this year is now in question.

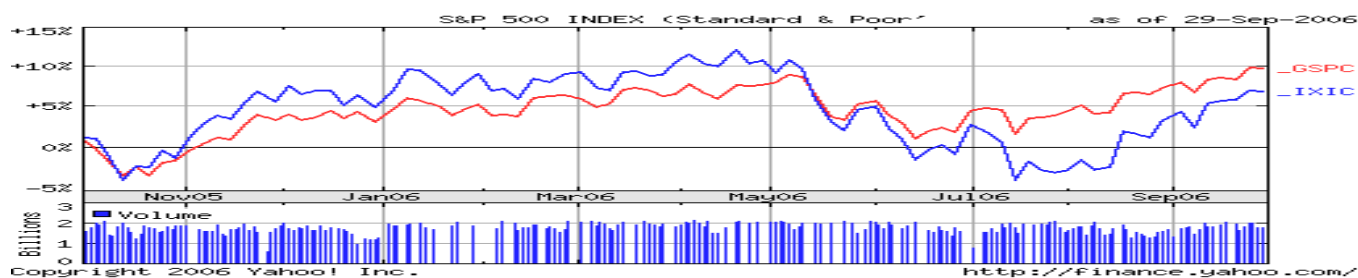
The dollar is still the international currency of choice even with the Euro gaining ground in the international arena. Now everybody hates the dollar, and negativity is everywhere in the market. The one million dollar question is what is going to happen to

the dollar. In the past three weeks the dollar rebound against the Euro and the CAN dollar. I believe if the dollar remains between 1.26 and 1.27 against the Euro for another 3 to 4 weeks, the dollar will gain against the Euro up to \$1.20. With the Yen I cannot think the dollar losing more ground to 120 Yen per dollar. The carry trades continue. I have a theory about the US currency. Since it is the true world currency no longer is the mirror of only the US economy, but is more a mirror of two third of the world economy. I will explain this in detail in my next newsletter. Many economists will disagree, but this is an important case to be studied. Stay tune.

Our model portfolio is made of between 45% to 47% in US dollar, about 20% Euros, about 5% in DKK, between 15% and 20% in CAN\$, between 10% to 12% in AUS\$, about 5% in BP, and we borrow Yen.

The Stock Market

In the past six months the stock market is doing the same thing, over and over. Everyone invest in the big stocks of the Dow, in oil, gas, utilities, big financial banks, and disregard or go short on small and medium cap stocks. Big is beautiful. The problem with this strategy is that it will backfire and for the smart money now is the time to load up small and medium cap stocks. Since I am a contrarian and a value buyer I insist in buying only valuable stocks, otherwise the money market or short-term bonds are good for me. I pick a variety of small and medium sized companies and few large. I am very interested in some small company with a market cap under \$1 billion in the health care field with no revenue, or growing revenue and an opportunity for a tremendous growth. As usual our model portfolio is well diversified with a balance of stocks, bonds, ETF's and a variety of stock options.



NASDAQ (IXIC) vs. S&P500 (GSPC)

Preferred stock list

Life Sciences: ABC*, ABT*, ARQL, ASTM, Biocell (Swiss BXLN), BCR*, BEC*, BDY*, BIO* BMET*, BRL*, BSX*, CEPH*, CRL*, DGX*, FLML*, HAE*, KG*, KND*, MAXY*, MCK*, MIL*, NTY*, NicOX (Nouvel Marché France), NUTR*, NVO, NVS* OCR*, PPDI*, RMD*, RNAI*, SHPGY* SONO* SYT*, STKL*, SUPG*, USNA* WPI* ZMH*.

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

Gold: BVN* GFI*, GLG*, GOLD*, NEM*, FOR (listed TSE).

Energy & Others

ATG*, BHI*, CHK*, CMI*, COP*, HBC*, LFC*, MOT*, MMM*, MKC* TXN*, UNFI* USU*, VE.

Our preferred list of ETF, open and closed funds:

BGRFX, EMF, EWJ*, GLD, IGR, PBW*, PHO*, RYSEX, TAREX, VGENX, VHGX, VSEQX, XLE*, XLU*.

* Shares with options.

Indexes: DJI 11,697.07 - NASDAQ 2,258.43- S&P500 1,355.85- Amex BTK 669.44- Russell2000 725.59- 10-Year Treasury Bond 46.33 – U.K. FTSE100 5,960.80 – Nikkei 225 16,281.86- PHLX Gold and Silver 128.42

\$-Euro 1.266 – \$-Yen 118.36 – \$-CAN 89.32- \$ - AUD 74.50\$- BP 1.87

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