

Overview

The ballgame is over

I have to admit that so far I like Federal Reserve's Chairman Dr. Bernake. He is far better than discredited ex chairman Greenspan, which caused the subprime lending global mess. Dr. Benjamin Bernanke is reputed to be a leading scholar on the Great Depression. I hope he is not going to allow the men and women who created today's credit mess to get out of it without paying a severe penalty, and I hope so. Insofar the CEO of Merrill Lynch and Citigroup's Chief Executive Charles Prince resign, and of course in the best tradition of Wall Street with a very rich severance package. It is time to get these high paid executives to pay substantial cash penalties for their mistakes, and not with outrageous severance packages. The Treasury caught the scheme being cooked up by several of the biggest banks to create a whole new fund, to be backed by them, which would buy some \$100 billion worth of the worst loans, mortgages, commercial paper and just plain debts that they had issued, all in the hopes of scooping up tens of billions of dollars in fees, commissions and profits. The idea was to have this fund buy up the most undesirable debt paper and hide it away in a portfolio, thus allowing the issuers to say they had cleaned up their act and had even made new fees and profits in dealing with the fund they would create and finance. The U.S. Treasury has give so far mixed signals, and Wall Streets' firms are

voting with their feet creating more uncertain and volatility in the market, and trying to twist the Fed's arm to return to negative interest rates, as their favored ex Fed Greenspan did in the past six years. Bernanke is telling the giant banks, hedge funds, investment banks and others that it is time to clean up. Are they listen? In the mean time the Fed is lowering interest rates and hopefully to a level that keeps the rates in the positive territory. Finally some banks start to comply with the Fed requests. In some cases, the difference between the values they had been carrying in their Structured Investment Vehicles and today's true market values were quite large, even 50%. The write-downs are now calculated in about \$250 billion. To accommodate such write-downs, some of the big financial houses have had to use up much or all of what now seem clearly too-small reserves for bad debts. We did not see the bottom of this ordeal yet.

The consumers mess

In the past seven years the household sector's mortgage debt increased by \$5.8 trillion, or 136%. At the end of the second quarter, household mortgage debt totaled \$10.143 trillion, compared with \$4.295 trillion in 1999. Yes we are talking TRILLIONS of mortgage debt. A capitulation of the American consumer spells trouble for the global economy. If I am right, and consumption now starts to slow, such a downshift will affect the entire U.S. economy. And I

fully suspect a downturn in America's economy will have considerably greater repercussions for the world at large. The macro structure of Asian countries remains very much geared toward an export-led growth dynamic. That means if the US consumer now slows spending, as I suspect, Asia will be hit hard - exposing a long-standing vulnerability that will draw the global economy into serious problems. A downshift of US consumption growth will affect Asia unevenly. That's especially the case for Japan, whose 2% growth economy could be in serious trouble in the event of a US demand shock that also takes a toll on Japanese exports into the Chinese supply chain. While less vulnerable than Japan, Taiwan and South Korea could also be squeezed by the double whammy of US slowdowns. American consumers are now at risk. Consumption expenditures currently account for a record 72% of the gross domestic product - a number unmatched in the annals of modern history for any nation. This buying binge has been increasingly supported by housing and lending bubbles. I would like to warn that both of these bubbles are now in the process of bursting. That will take the United States into a recession. The current financial crisis is a wake-up call for central bankers, and Wall Street. Free money for U.S. consumers is over. Now let's go back to the good old time of borrowing with money down. As you know there is no free lunch. Again thank you Mr. Greenspan and your Wall Streets robber barons for this mess.

The stock market

If you noticed lately the volatility has increased dramatically. I forecasted the increasing volatility since the beginning of the year. Now moving forward I believe the volatility will further increase. Therefore, the best way to protect your portfolio is either increase the liquidity up to 60% of

your portfolio, or hedge the stock portfolio in buying index puts, or single stock puts. You must have the know how of what are options, otherwise find a reputable advisor that can do it for you. In the last year or so I was bullish for the energy sector. If you read my previous newsletters you notice the comment on such sector. Now what to do? At this point with the possibility of a recession I am between 30% and 50% in liquidity. The rest is invested in stocks, options, ETF's and so on. Our preferred stock list did very well in the past year. I have been bullish on gold since the gold went above \$325. I also correctly forecasted the gold flying to \$750 per ounce. Now I believe it will hit \$845 in the next six months. Being the only true word currency gold keeps the value of the trade. If oil will reach above \$100 per barrel, gold could go to \$1,000 per ounce. Of course a full blown recession could hamper such a price. Remember the glass is always half full, and you must look for investment opportunities.

Currencies

In the past three years my prediction on currencies has been consistent. Now that the target of \$1.45 per Euro, and the parity with the CAN dollar have been materialized, I think I will diminish the Euro position and invest in Canadian dollars, and Australian dollars. Currencies alternatives to Euro are DKK and NOK. With then scenario above I remain with the following model portfolio:

US Dollar about 35% to 37%, Euro 16% to 18%, Danish Kronen about 7%, CAN Dollar about 20%, AUS dollar between 14% and 16%, British Pound about 5%, NOK about 5%. I believe in moderate leverage. There is a maximum of 20% leverage on the model portfolio, which means if you invest \$1 million, you borrow no more than \$200,000.



Preferred stock list

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

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

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

Energy & Others

ATG*, BHI*, CHK*, CMI*, COP*, HBC*, LFC*, NVIC.OB, MOT*, MMM*, MKC* QCOM*, SU*, 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.

Have a Great day

Dario A. Bianchi

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