The Strategic Global Investors Newsletter™

www.capitalife.com

11 February 2006 No. 73

Intelligence report

The flow of money

Canada

On January 24, The Bank of Canada hits its 6th 25-bp rate hike of the present tightening cycle. Also, the Bank has indicated: "interest rate would be required to keep aggregate supply and demand in balance and inflation on target over the medium term." This rate increase lifts the overnight rate to a 4-year high of 3.50%, and the real overnight rate to 1.9%, relative to the annual core inflation rate of 1.6%. This would be the highest real overnight rate since August 2001, and the first time that the real rate exceeds the core rate within the same period. Escalating real rates of interest present rising yields in a stable inflation environment, which is a favorable formula for any currency.

United States

The story of the slowdown of the US housing market took a turn for the worse when existing home sales fell 5.7% in December, marking the third consecutive monthly decline. This was the longest line of falling sales in 3 years and the lowest reading in 2 years. Median prices fell to $211,000 from November's $215,000.

The Commerce Department reported the U.S. trade deficit soared to an all-time high of $725.8 billion in 2005, an increase of about 17% from the previous year. The deficit with China, Japan, Europe, OPEC, Canada, and Mexico hit an all-time high. Worries over the trade deficit and broader current account deficit had put pressure on the dollar in 2004. However, the dollar in the last two months is trading in the same trade range of 1.19-1.23 against the Euro. This suggests traders are now more focused on the U.S. economy and the prospect of possible further increases in U.S. interest rates.

Key Points**:** Despite the 41% and 74% declines in net foreign purchases of US stocks and US Agency securities respectively, and despite the 176% increase in net US purchases of foreign stocks, total net capital inflows increased because private institutions' purchases of US treasury bonds doubled to $50.8 billion, making up 93% of the increase in total purchase of US Treasuries and financing up to 79% of the November trade deficit.

Hedge Funds Finance 80% of Trade Deficit.

Net foreign capital flows into the US slipped 1.4% to $89.1 billion in November from a revised $104.2 billion in October. Japan, the largest holder of US treasuries has kept its holdings around the $680 billion mark for the past 12 months in contrast with Caribbean offshore centers which have risen 7.1% to $115.3 billion in November, and 65% over the past 12 months. Thus, the conclusion that part of those "hidden" central bank purchases of treasuries flowing via Caribbean offshore centers could be from the central banks of OPEC nations such as the Saudi Arabian Monetary Authority and the National Bank of Kuwait.

Purchases of US treasuries by foreign official accounts (central banks and supra nationals) fell 24% to $3.7 billion, making up for a mere 7% of the total increase in foreign purchases of treasuries. More strikingly, official purchases made up less than 50% of the increase for the 5th straight month. While the contrasting interest between official and private accounts raises immediate concerns about the trade deficit being at the mercy of speculators, it may well be argued that central banks are snapping up US treasuries via hedge funds and currency overlay managers which fall under the "private" portion. The fact that a significant share of the US trade imbalance has been increasingly financed by volatile sources such as hedge funds reflects the uncertain nature of the financing. We know hot money moves around the world at the speed of light. <u>In the next six to 9 months I expect the Dollar to devaluate at least around 1.30-1.35 against the Euro, around 0.90 to 0.94 against the CAN Dollar, and at 107-110 against the Yen.</u> This will happen because of the above implication and the fact that the U.S deficit and national debt are unsustainable. Please bear in mind the CAN dollar is one of my favored currencies for 2006.

The Stock Market

In the past three months the NASDAQ has been in the trading range between 2200 and 2325 with today closing at around 2260. The S&P500 has been trading between 1220 and 1290, with today closing at around 1266. This means that the market is “treading water.” The uncertainty surrounding the war in Iraq, the problem with Iran, the trade deficit, rising interest rates, the flattening of the yield curve between long-term and short-term interest rates, are increasing creating a net outflow of investments to Europe and Asia. If this trend continues there will be fewer jobs on Wall Street. <u>I believe that under these circumstances one of the best sectors in which to invest is the life sciences sector.</u> Health care is expanding worldwide and America is still the leader in this field. Other interesting sectors include REITs, energy, and precious metals. As always, the glass is half full and I have provided a preferred stock list below. Now, a few comment about Abgenix. Abgenix has been on our preferred list for the past two years, and since 1999 has been on our preferred list off and on. Amgen has purchased the company and I am, therefore, removing ABGX from our list. In the meantime, investors that invested in ABGX since 1999 have made an 11-fold profit on their investments. I normally invest in these stocks using a combination of stocks and options. Many stock on our preferred list such as ASTM, PPDI, DSCO, HAE, USNA, SHPGY, have increased 100% to 1200% (twelve-fold) in the past six years. Some have now increased from 100% to 500% from their lows. I use options on medium- and large-size companies because in doing so, I believe that the volatility of the life sciences sector increases the opportunity of reducing the investment risk.

<u>Gold.</u> I believe that gold will correct from these levels. I sold 50% of my holdings and I will buy back when gold is around $520-$530 per ounce. <u>The medium-term horizon (1 year to 18 months) calls for gold at around $600 to $650 per ounce.</u>

Preferred stock list

<u>Life Sciences</u>: ABC*, ABT*, ADS (listed TSE), AXCA, ARQL, ASTM, BAY*, BCR*, BEC*,BDY*, BIO* BIPH.OB, BMET*, BRL*, CEGE*, CEPH*, CRL*, CYT.TO, FLML*, DSCO, HAE*, KG*, KND*, MAXY*, MCK*, MIL*, MLNM*, NTY*, NicOX (Nuveau Marche' France), NBIX*, NUTR*, NVO, NVS* OCR*, PPDI*, RMD*, SHPGY* SYT*, USNA* WPI* XRAY*.

<u>REIT</u>: EQR*, GLB, HCP*, HCN, IGR, HMT*, HR, HRP, KIM*, PCL*, TCO*, TRC, PSA. Also preferred convertible shares in EQR, HMT, HRP, and TCO.

<u>Gold</u>: BVN* GFI*, GLG*, GOLD*, NEM*, FOR (listed TSE).

<u>Energy & Others</u>
ATG*, CHK*, CMI*, COP*, HBC*, MOT*, TAP*, TSO*, MMM*, MKC* UNFI*.

<u>Our preferred list of ETF, open and closed funds:</u>
BGRFX, EMF, EWJ, GLD, PBW, RYSEX, TAREX, VGENX, VHGEX, VSEQX, VGSTX, XLE, XLU.
* Shares with options.

Indexes: DJI 10,919.05 - NASDAQ 2,261.88 - S&P500 1,266.99 - Amex BTK 698.48 - Russell2000 717.13 - 10-Year Treasury Bond 45.81 – U.K. FTSE100 5,764.10 – Nikkei 225- 16,257.83 - Amex Gold 310.21
$-Euro 1.1898– $–Yen 117.91- $-CAN 86.72- $ - AUD 73.74

Dario A. Bianchi

Disclaimer

We strongly recommend that our readers do their own research into any type of investment to evaluate their risk or to consult with an investment advisor before investing. Information published in this newsletter is from sources deemed to be reliable. We are not, however, responsible for its accuracy and reliability. From time-to-time, Capitalife receives compensation for services, such as technology transfer or in the organization of the Bioscience conferences, from a few companies in its preferred list of this newsletter. However, Capitalife does not receive any compensation from the majority of companies and no compensation from funds or ETF recommended in its newsletter. Reader's use of this publication is entirely at its own risk. The Information is supplied on the condition that the reader or any other person receiving the Information will make his or her own determination as to its suitability for any purpose prior to any use of the Information. Nothing contained in this newsletter shall constitute an offer to sell, or the solicitation of an offer to buy securities. Our recommendations, if any, are subject to change without notice. <u>Capitalife and its officers may from time-to-time hold investments in the securities above discussed.</u>

info@capitalife.com