

Overview

After the war with Iraq what will happen to the global economy? First let's examine oil production. The prospect of a large increase in oil production from Iraq—which has the world's second-largest proven reserves—could, eventually, lessen American dependence on the Saudis. Already, states such as Kuwait, Oman, and Qatar are moving toward more democratic regimes. They will be the most dependable Arab allied to the U.S. and the new Iraq. The successful introduction of democracy in Iraq could also increase pressure on neighboring countries to move towards a more representative government. Judging the outcome is very difficult due to the meddling into Iraqi affairs by anti-American states such as Syria and Iran.

Europe

In Europe, the Germans are trying to make reconciliatory overtures to the Americans. Spearhead by the Minister for the Economy and executives of multinationals corporations, the Germans are already on the move. Retaining France's traditional place at the center of European policymaking is clearly one of Mr. Chirac's most cherished ambitions. In the past, French influence has largely derived from a strong Franco-German relationship and it is that which Chirac has sought to consolidate. But even Chirac is aware of the dangers of a long-term rift among the existing EU members. The power structure is shifting, and not necessarily in France's favor. The French position is harder to reconcile with the U.S. They are now using high-level government discussion with Poland to benefit reconciliation. Moreover, the French government is discussing with the British how

to initiate reconciliatory discussion with the U.S. In America, there is a popular movement to boycott French products and deride French government officials. I think if France wants to participate to the reconstruction of Iraq it must pay a price. One nation to watch is Spain. Prime Minister Aznar is gaining clout quickly. Italy, Spain, Portugal, Greece, Poland and the new eastern European state choose to be on the U.S. side. France, with its tentative to block the Iraqi war, created a divide that it will take time to heal. In the meantime, it will be the European nations that stand to lose most from the \$2.5 trillion EU and U.S. trans-Atlantic economy. Many in the U.S. business community think that Europe (excluding the U.K. and Ireland) has entered a kind of welfare-state paradise in which structural reforms and defense spending are not on the table. Then French and Germans complain of the American "hegemony." Unemployment is almost twice what it is in America, and the population is aging more rapidly than in the U.S. In addition, productivity is 25% to 30% less than in the U.S. With this in mind, in Europe I forecast an average GDP growth of between 1.6% to 1.9% in 2003, and 2.0% to 2.3% in 2004. In my opinion, real inflation in 2002 was over 7%, and in 2003 it will be around 4%. As the continent has stagnated, Germany, Europe's largest economy, will be lucky to escape recession again this year. Otherwise we are looking at 2005 and beyond. If serious reform is made by member states, most notably Germany, unemployment will be reduced by the first or second quarter of 2004. For example, Germany's weak growth is as much due to structural factors as to the downturn in the world economy. Their non-

wage labor cost, equal to 42% of gross wages, is far too high. All EU governments this year will spend much more than the last two years and their deficits will grow even further, going above the percentage established by the Maastrich treaty. Anything which deters businesses from investing and consumers from spending would, at this stage, delay recovery further and in some cases, bring economies back into recession. Positive news for the EU is the increased value of the Euro, that it will keep a lid on prices especially oil, food, and commodities. But I think this is only temporary. As soon as the U.S. dollar hits around \$1.15 against the Euro, I believe that the greenback will return to a more balance exchange rate of \$1 to \$1.05 per 1 Euro.

United States

For fiscal year 2002, the Department of Treasury and the Office of Management and Budget (OMB) reported an accrual-based net operating cost of \$365 billion. The report covers more than \$1.9 trillion in revenues and \$2.3 trillion in operating costs, as well as responsibilities and social insurance commitments, such as Social Security, Medicare, and liabilities including civilian and military retirement pensions and benefits. What worries many economists is the broader context in which the war is taking place. The world's biggest economies are already relatively weak. In spite of everything, the American economy has been growing somewhat faster than most of the big industrial economies, and most forecasters still reckon on a reasonably healthy pace of expansion this year. There are now three risks threatening these optimistic assessments. Business investment has yet to recover from the aftermath of the dotcom bubble. Another spectacular terrorist attack on American soil would also knock domestic confidence. And the debt load of many major corporations around the world, combined with major losses in various industries such as airline, tourism and hotels. The other risk facing America is one that divides economists into two clear camps. Some argue that the uncertainties caused first by the prospect of war and now by the conflict itself are the only

obstacle to sustained recovery. They believe that once the fighting is finally over, growth will quickly pick up. But another group believes that the American economy is plagued by structural imbalances that could continue to constrain growth even after the war is over. The current-account deficit, now around 5% of GDP, is a key factor: if capital flows into America slowed even more sharply, or dried up, the adjustment involved in reducing the current-account deficit could be painful both for America and the rest of the world. The other imbalance that troubles economists is the American government's deficit. Under the Bush administration, large projected surpluses have turned rapidly into deficits as far as the eye can see. The huge \$550 billion tax cut which President Bush has been seeking has to be seen how it will affect the economy. If with the tax cut it will be a cut in government spending, then we should have a recovery effect. That it will be difficult because defense spending has increased substantially in the past 12 months. Probably most of the money will increase the budget deficit for the current fiscal year. This year defense spending should be equal to about 4% of the GDP. This in turn will keep defense business running to the tune of \$400 billion. It seems the old economy keeps business running. Housing starts is still high at about 1.6 million unit in March. Also, renovation of older homes keeps at healthy pace, thus making the economy running. Mostly real estate investments, health care spending, and defense spending will sustain this year the U.S. economy. I do not believe the Federal Reserve will reduce short-term interest rates again this year. I forecast that the Fed will shift from lowering interest rates into buying long-term U.S. treasury bonds, thus reducing long-term interest rates. Short-term interest rates will increase in the third quarter of this year. Moreover, this year the GDP growth should be between 3 and 3.5%. In the third and fourth quarter we should achieve a 4% growth.

China

The disease, which has killed more than 200 people and infected more than 3,400 in 23 countries, has turned Hong Kong and China

upside down, and it is threatening to send parts of Asia into a recession. Now it is starting to affect the way some global companies operate. SARS, or Severe Acute Respiratory Syndrome, is raising almost as many financial questions as it is public health worries. In industries ranging from airlines to chipmakers to small businesses, the cost is already being felt in terms of lost production and lost opportunities. If the disease becomes more widespread and dangerous, the eventual cost to business could be staggering. The Pearl Delta area in South China is home to the largest electronic manufacturing integrated complex in the world. Hundreds of manufacturers will be affected by SARS and there is no a quick solution. It is very difficult to set up new manufacturing plants needed to manufacture TV set, computer monitors, circuit board, etc. in other parts of the world. It will take years. Some companies are now planning to move manufacturing in other part of the world such as Mexico, where jobs are more expensive than China, but more closer to the U.S. and safer.

The Stock Market

In the 1990s, chief executives were portrayed as heroes and their pictures graced the covers of business magazines everywhere. Now if they make the front page, it is for very different reasons: they are being handcuffed for various types of corruption and for money stolen from publicly traded corporations. So it should come as no surprise that recent company filings suggest the pay packages of senior managers have been restructured to make it harder for bad bosses to walk away with undeserved millions. And yet, the same filings also show that in 2002, when shares continued to fall, most chief executives still got a healthy pay raise. The backlash against perceived executive greed has differed from country to country. In America, new rules are having a powerful effect. New rules on shareholder's interested in respect to complicated disclosures of executive share sales will make bosses less likely to try to engineer, and profit from a short-term hike in the share price. Shareholder litigation has probably had just as profound an effect on

attitudes as any new rules and regulations. Lawyers have been alleging breach of trust where executives have rewarded themselves handsomely while the company slumps. Investors who look after union money are getting particularly uppity. The AFL-CIO, a giant American trade union, has submitted motions calling for reform of executive compensation already this year. Despite the increase in pressure from shareholders, and the scramble at many companies to rewrite compensation schemes, there is little sign of top-level salaries dropping in line with share prices and profits. On the contrary, median senior total pay among America's top 350 companies rose by 10% last year, even as median total shareholder returns in those companies fell by more than 5%. If this is the amount of heat that executives are feeling after the past three years of scandal and value destruction, there is little chance that pay awards will be restrained once the good times roll again. This is one more reason for investors to refrain from re-entering the stock market. I believe that since the month of February the market has bottom. Volatility is still here but more moderate. I think that the NASDAQ index will trade between 1,330 and 1,550 in the next three months. Some profit taking should start soon and we will go down about 70 points on the NASDAQ. After that we should have a new rally. All it depends on companies' revenues on the first quarter reports and how the geopolitical scene evolves. As a long-shot forecast on the stock indexes I think that by years' end we should have the DJI index between 8,900 to 9,200 and the NASDAQ index between 1,600 to 1,670. The BTK (AMEX Biotech index) under perform the NASDAQ composite and the S&P500 indexes from November 2002 to today. Soon or later the BTK will perform in line with the NASDAQ, and therefore I think it is time to consider selective biopharmaceutical and life sciences companies. Since the end of 2002, I have increased our stock exposure and our currency diversification. My model portfolio is made of 50% in U.S. dollars, and the rest between Euros, CAN dollars and AUS dollars.

Moreover, the model portfolio is about 35% in stocks and options and about 65% in money market, and A or better short-term rated bonds. I hold large sum of cash in our model portfolio to cover our options trading activity.

Preferred stocks list:

Life Sciences: AAA, ABT*, AXCA, ASTM, AVE*, CEGE*, CYTC*, DVSA*, CEPH*, CHIR*, GDT*, GENZ*, GSK*, GILD*, IVX*, KG*, MATK*, MEDI*, NicOX (Nouvel Marché France), MLNM*, NBIX*, NRM.TO, PPDI*, PTI.TO, SCLN, SYT*, and WPI*.

REIT's: GLB preferred shares, KIM preferred shares and SHU preferred.

Our preferred list of mutual funds:

BGRFX, PBFOX, OAKGX, RYSEX, VGENX, VSEQX, VGSTX.

* Shares with options.

**Indexes: DJI 8484.99 - NASDAQ 1,451.36- S&P500 911.37- Russell2000 391.16- Amex BTK 346.48
10-Year Treasury Bond 39.83- U.K. FTSE 100 3,917.70.**

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