

Overview

As I wrote in my newsletters last year real inflation will hit 4% to 5% this year and around 6% next year. With the price of oil increasing around 30% in the last 12 months there is no alternative for companies but to increase the prices of goods and services in all sectors of the economy. This scenario is here to stay. Recently the Saudis declared that they would like to increase production. We will see what happens within the next few weeks. Yet more than 30 years after the embargo began, the facts seem crystal clear: the U.S. remains addicted to Middle Eastern oil. Unfortunately, many of the rich world's governments—and above all the U.S. government, the world's biggest oil consumer—are reluctant to adopt the measures that would speed the day when OPEC's worst fears of losing control come true. If treating the U.S. addiction to oil will be costly, is it really worth doing? Definitely. Petro-addiction imposes mighty costs of its own. First, there is the political risk of relying on OPEC. Oil still has a near monopoly hold on transport. If the supply is cut off for even a few days, the U.S. economy could grind to a halt. And despite what sound like large confirmed reserves in new oil fields in Russia and elsewhere, Saudi Arabia's share of the world market will actually grow over the next two decades. Because of this ongoing concentration of supply, the risk of a disruption to oil flows will continue to be a viable threat, and may even rise. We have had tremendous advances in technology that we are not yet using. Hydrogen fuel cells and other ways of storing and distributing energy are available right now. These are no longer a distant dreams but a foreseeable reality. Switching to these methods will not be easy, or all that cheap, but with the right policies it can be made both possible and economically advantageous. Hybrid cars for example will sell briskly in the U.S. this year.

European Union expansion could manifest into a drop in the Euro.

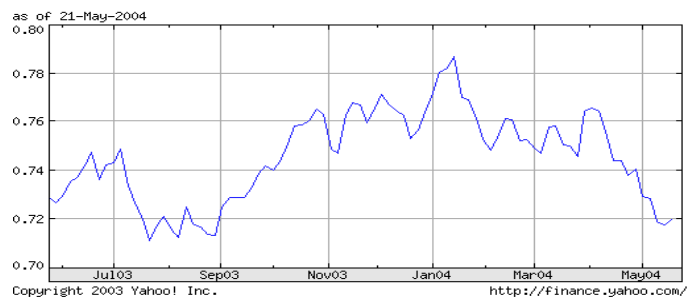
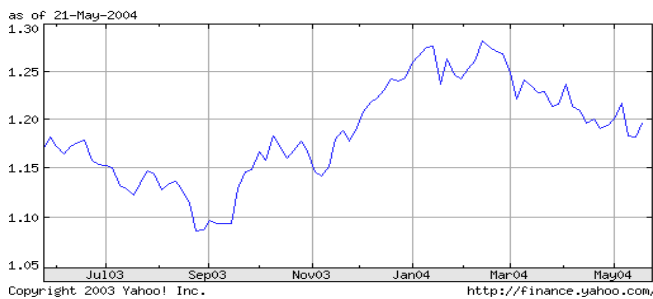
Rather to think about various theories of the universe, it is possible to imagine a European Union that goes on expanding, one that reaches a certain size then remains stable, or one that eventually implodes. So far, the EU continues in its expansionary phase. On Saturday May 1st it undergoes its fifth and most ambitious enlargement since its foundation. Already, there are worries that the current enlargement will prove a step too far. Getting agreement between 25 squabbling countries may prove nearly impossible. A poll last December by Eurobarometer found that fewer than half of its people now agree that the Union is "a good thing". The EU has to deal with not only different market zones, but also with linguistic and cultural differences. The mammoth books of EU rules, may also weigh heavily on the lightly regulated economies of central and Eastern Europe. Some of their tax breaks for investors will now be banned by EU law, for instance. Many now hope that the demands of entry to the single currency—unlikely as it is before 2009—will reimpose some discipline on central Europe's budget makers. Remember that the European Central Bank, led by the ample funds of the Bundesbank, was forced to intervene in October 2000 to keep the Euro from sliding to new all time lows below 82 cents as bullish sentiment for the single currency plunged. The ensuing relief rally was quickly reversed and one year later the Euro was again on the ropes. By November of 2001, however, traders were considerably less bearish on the Euro's prospects and expected the ECB to intervene both verbally and monetarily to direct the Euro higher. The exchange rate trend of the last two months suggests that the Euro may

have reached a significant top at 1.2925 in January. There also can be a significant amount of symmetry within directional patterns of markets.

As the Euro appeared ready to breach the 1.3000 levels in February, the market again expected the ECB to intervene-but this time to weaken the Euro either through a rate cut or actual monetary intervention in the foreign exchange market. Although the ECB did not take action, there was a subtle shift in the policy statements coming out of Brussels. As members of the EU, the new entrants must strive towards membership of the single currency as soon as possible. But to qualify for membership, the EU's new countries must somehow show that their economies have "converged" with those of the Euro zone. Convergence must be fiscal as well as monetary. In accordance with the "stability and growth pact," public debt must be kept under 60% of GDP and budget deficits must be held to 3% of GDP or less. With the Euro at current levels, this convergence looks to be a long shot at best as central Europe is not yet ready to meet these standards. Poland's deficit was estimated to be 4.5% of GDP in 2003. Slovakia's was 5%. Hungary's might be anything from 5.6% to 6%. And the Czech Republic, with a deficit of close to 8%, is the biggest basket case of the group. Granted that the addition of these former Soviet satellite nations won't single-handedly push the Euro lower, but it is clear that the addition of the "Old Europe" to the EU will represent more of a drag than a boost to growth throughout the entire region. Veteran investors will remember how swiftly the Deutschmark fell after the re-unification of East and West Germany in June of 1990-and that represented less than 15 million people. If the Euro indeed confirms to have peaked at 1.2925, the ensuing decline should last for approximately 40 to 60 % of the advance. That would mean an increasingly firmer Dollar versus the Euro for the next 9 month and a price target as low as 1.10. Technical confirmation for this price scenario would come upon a break below the Euro's two-year up trend line at 1.1850. Fundamental confirmation could come as soon as the market prices in the cost of Euro-expansion.

The U.S. Stock Markets

The growth in jobs, which beat expectations for the first time in five months, was strong enough that investors ignored warnings from numerous economists that the data may prompt the Federal Reserve to adjust its accommodative interest-rate policy. This week the 10-year Treasury bond closed at 12-month lows after the stronger employment report raised the likelihood that the Federal Reserve will raise interest rates sooner rather than later. The benchmark 10-year Treasury raised its yield up to 4.80% from 3.89% of three weeks ago, and it closed at 47.64. Sector stocks tied to interest rates, such as REIT's, have lost about 10% to 15% from their highs of the last 12 months. Now it might be the time to consider some of REITs with strong market positions. With the Dow Jones Industrial Index that is trading water around 10,000, and the NASDAQ around 1,900, I do not see too much upside potential in the short term. I am afraid that the mortgage market could bring the financial system down. Fannie Mae and Freddie Mac, the two largest mortgage holders in the world, with a combined portfolio of over \$1 trillion, have developed a system that has too many bugs. You may have read of the recent concern coming from the U.S. Government regarding the accounting practices of Fannie Mae. These organizations together with other-leveraged banks and the wide use of complex derivatives could bring about a collapse of the financial system. This is not something you should take lightly. For this reason, investors should be diversified into gold and silver stocks, as well as own a piece of real estate. I suggest to take a look at Plum Creek Timber (Symbol: PCL), or Public Storage (PSA) as a solid investment against inflation and turmoil in the markets. If you prefer, you may invest in one of the best REIT mutual funds: Third Avenue Real Estate Value (Symbol: TAREX).



US Dollar versus Euro

US Dollar versus CAN Dollar

We keep our global portfolio in the following currencies: U.S. Dollar 40% Canadian Dollar 25% British Pound 10%, Euro 25%. Investments in money market 15%, in A or better rated short-term bonds 30%, 55% in the stock market.

Our preferred stock list

Life Sciences: ABC*, ABT*, ABGX*, ACEL, AXCA, ARQL, ASTM, AVE*, BEC*, BIO* BMET*, BRL*, CEGE*, DVSA*, DSCO, CEPH*, CHIR*, FLML*, GCOR, GSK*, KG*, MCK*, MLNM*, MEDI*, MYL*, MYGN*, NTY*, NicOX (Nuveau Marche' France), MLNM*, NBIX*, NRMX, NTEC, PPD1*, SCLN, SYT*, and WPI*.

REIT's: GLB preferred shares, KIM preferred shares and HMT preferred, PSA, and PCL,

Gold Stocks: GFI*, FOR.TO, GOLD*, NEM*.

Our preferred list of mutual funds:

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

* Shares with options.

Indexes: DJI 9,966.74 - NASDAQ 1912.09- S&P500 1093.56 - Russell2000 545.81 - Amex BTK 497.37- 10-Year Treasury Bond 47.64- U.K. FTSE 100 4,431.40- Euro-U.S. dollar 1.199

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