

# The Strategic Global Investors Newsletter™

www.capitalife.com

9 May 2006

No. 75

## Intelligence report

The dollar continued to dive across the board in spite of a stronger than expected set of US economic data. It hit fresh 14-year lows versus the Canadian dollar, new 8-month lows against the euro and breaching a key support level to the Australian dollar. An upbeat batch of US economic reports failed to deter the selling of the greenback with markets maintaining its bearish sentiment on the currency.

Due to the Fed's reliance on economic data in determining the length and the depth of its current tightening cycle, softer than expected inflation data will further fuel the argument that May's anticipated 25-bp rate hike to 5.0% may be the last. I believe that will not be the case. Housing data for March was also worse than consensus estimates. March housing starts fell by 7.8%, matching the upwardly revised drop from February at 1.96 million units, its lowest level since March 2005. Housing permits tumbled by 5.5% compared with a 1.7% drop previously and falling to its lowest rate since last year at 2.021 million units.

### U.S. Banks: Big casinos?

Derivatives were designed to help banks, corporations and countries hedge against risk. But banks found they could make a killing by managing more exotic derivatives that effectively bet on the future direction of interest rates, foreign exchange,

commodities and stock indexes. And since banks are not making too much money from traditional lending any more, derivatives are a fantastic new way to net huge gains. And why not take some big risks when the Fed will "supposedly" back you. As I see it, America's banks have turned into giant casinos. Are you banking with one of them?

Here is the list of the 10 largest banks exposure to derivatives.

J.P. Morgan Chase Bank	\$48 trillion
CitiBank	\$21 trillion
Bank of America	\$21 trillion
Wachovia Bank	\$3 trillion
HSBC	\$3 trillion
Bank of New York	\$790 billion
Well Fargo	\$430 billion
State Street	\$252 billion
Bank & Trust	\$147 billion
National City	\$116 billion

### Money supply: Free money?

Free money has its price. In the first 5 years of the Presidency of George W. Bush (January 2001 to January 2006), the M2 money supply grew by \$1.7 trillion. That averages out to \$340 billion a year. Wow! The flood of money has never been greater in history. Last year, US homeowners drew over \$700 billion in cash from the value of their homes, compared to \$632 billion in 2004, with the spending fuelling consumption. Japan has flooded the market for 15 years now, with almost zero interest rates policy. The U.S. has learned from Japan and did the same in the

past five years. The Fed let real interest rates in the negative zone for too long and now it raises interest rates and instead of decreasing liquidity, keeps increasing it which in turn will fuel inflation. This policy is very risky for the market. It might be that new Fed Chairman Bernake is working hard to achieve the same money policy as his predecessor Mr. Greenspan. For all of us it means print a lot of money and raise interest rates, so that people think that he is fighting inflation. If you have any doubt please check the price of gold and other commodities in the last 2 years. Gold is one of the leading indicators for inflation. I correctly forecast gold prices in the past sixteen months. To do a forecast now is more difficult due to many variants. In any event this is my next forecast: at the end of this year gold prices should reach around \$725 to \$750 per ounce. It could go as high as \$800. It depends on the dollar exchange rates, the interest rates, and the political situation in Middle East. This is real money. If gold will go above \$800 all bets are off. We could have either double digit or runaway inflation, or the economy could go into a depression.

### **China**

Most of big U.S. banks are accelerating investments in China, with the assumption that the government control of about 80% of all commercial and industrial activity guarantee the money will return without to much risk. And with the events of the past month I am absolutely convinced I was right. It is going to Red China. Very few people think the majority of the Chinese banking system is broke, due to bad loans to government and private owned enterprises. U.S. bankers go to China and all they see is Shanghai skyscraper, which the Chinese keep building no matter who will rent them.

I have already seen this building madness in the U.S. in the past. I still remember in the beginning of the 90 when you could buy a 10 story building in almost any town for 50 cents to the construction cost. Moreover Chinese exports are surging at very low or nonexistent profit margins in order to sustain a financial system that has accrued a non-performing loan burden that is, by some measures, as high as 60 percent of gross domestic product. The United States is addicted to Chinese imports, and China is addicted to exporting to the United States. The United States wants China to revalue the Yuan in order to raise the price of Chinese exports. The Chinese, eager to maintain and increase exports, have no intention of allowing a meaningful rise in the Yuan. In the mean time there are other forces binding the two countries together as well. The most important is Chinese money -- which is flowing out to other countries precisely because China is no longer a particularly attractive place for Chinese investment. There is serious capital flight under way, as money is redeployed to safer havens. So where do you invest now? For the short-term China is still ok, but for the long-term check out India, or Eastern countries in Europe.

### **Social Security and Medicare**

The trustee of Social Security and Medicare deliver the following scenario:

1) The unfunded liability of the Social Security program grew by 20 percent (from \$12.8 trillion to \$15.3 trillion) while Congress dithered over reform proposals.

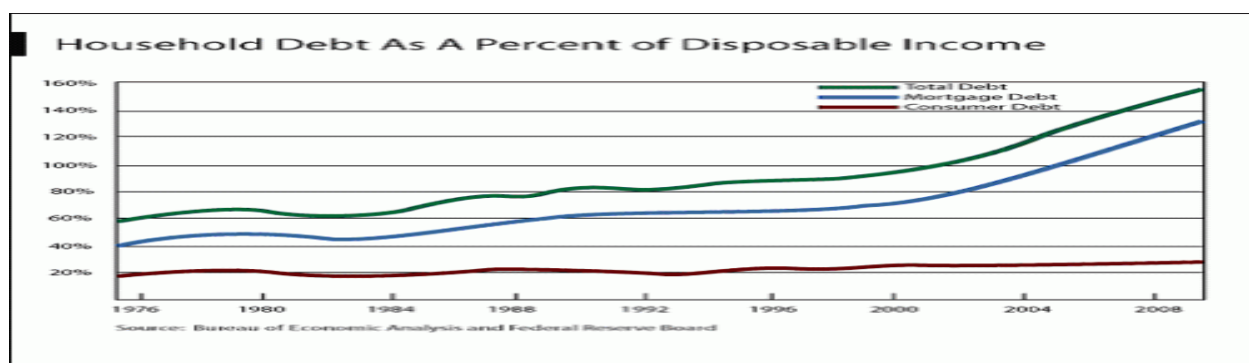
The Social Security gap is still smaller than the unfunded liability of just the Medicare prescription drug program, which weighs in at a robust \$16.2 trillion.

2) The total unfunded liability of Medicare topped *\$70 trillion*.

3) The trustees' estimate of the unfunded liability of the Medicare drug program actually shrank 11 percent from their 2005 estimate of \$18.2 trillion. But that reduction was more than offset by a 2 percent increase in the unfunded liability of the physician insurance part of Medicare (from \$25.8 trillion to \$26.2 trillion) and a 16 percent surge in the unfunded liability of the hospital part of Medicare (from \$24.4 trillion to \$28.4 trillion).

4) Medicare will run out of assets by 2018. Ten years from now. Enjoy the services until you can.

To this scenario we can add the unfunded liabilities of private pension plans, of such companies as General Motors, Ford, and other major employers. The numbers are staggering. Only inflation and reduction on benefits will be able to pay for all these services therefore, reducing the net income of workers.



## Currencies

The Dollar falls to 113.3 versus the Yen today, at the historic lows versus the Canadian dollar at US\$0.904, and drifting lower against the Euro at 1.261. The dollar started its declines after the Swedish Central Bank was the latest to shun the US currency, announcing that it has cut the proportion of its USD reserves from 37% to 20%, while raising its euro holdings from 37% to 50% of its \$21 bln reserves in foreign exchange. The topic becomes especially dollar negative after the United Arab Emirates said it planned to shift 10% of its FX reserves from US dollars to euros. That is a significant event due to the fact that it was the first time than an Arab Gulf state expresses its intention to reduce its dollar holdings. I forecast within the next three months the U.S. dollar to trade with the Euro between 1.30 and 1.35. The CAN\$ will trade between \$0.92 and \$0.95. I predict at the end of the year we should have the following exchange rates: US\$-Yen 107-108, US\$-Euro exchange rates of \$1.32 to \$1.36, US\$-CAN\$ between \$0.93 to \$0.97. The currency market from now on will be very volatile and this year we could witness exchange rate swing the same as it was in the 1970. Our model portfolio is made of about 45% in US dollars, about 20% in Canadian dollar, about 20% in Euros, about 10% Danish Kronen, and about 10% in Australian Dollars.

## The Stock Market

My model portfolio is made of about 40% to 50% by life science companies and the rest REIT, energy, precious metals, and ETF stocks. I also firmly believe in hedging stocks with options (puts and calls). You can do your own research in investing and compare with my preferred stock list here below and previous newsletters on our website.

## Preferred stock list

---

**Life Sciences:** ABC\*, ABT\*, ANX, AXCA, ARQL, ASTM, BAY\*, BCR\*, BEC\*,BDY\*, BIO\* BIPH.OB, BMET\*, BRL\*, CEPH\*, CRL\*, FLML\*, DSCO, HAE\*, KG\*, KND\*, MAXY\*, MCK\*, MIL\*, NTY\*, NicOX (Nuveau Marche' France), NBIX\*, NTOL, NUTR\*, NVO, NVS\* OCR\*, PPD1\*, RMD\*, RNAI\*, SHPGY\* SYT\*, STKL, USNA\* WPI\* XRAY\*.

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

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

### **Energy & Others**

ATG\*, BHI\*, CHK\*, CMI\*, COP\*, HBC\*, LFC\*, MOT\*, TSO\*, MMM\*, MKC\* UNFI\* USU\*.

### **Our preferred list of ETF, open and closed funds:**

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

\* Shares with options.

**Indexes:** DJI 11,416.45- NASDAQ 2,309.84- S&P500 1,313.21- Amex BTK 662.30- Russell2000 767.61- 10-Year Treasury Bond 51.10- U.K. FTSE100 6,082.10- Nikkei 225- 17,153.77- Amex Gold 384.33  
\$-Euro 1.2619- \$-Yen 113.34- \$-CAN 90.55- \$ - AUD 76.61

*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. Capitalife and its officers may from time-to-time hold investments in the securities above discussed.

Copyright © 2006 • By Dario A. Bianchi • Capitalife Inc.

[www.capitalife.com](http://www.capitalife.com)

[info@capitalife.com](mailto:info@capitalife.com)