

The Strategic Global Investors Newsletter™

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Overview

In the December, 1999, newsletter I wrote “we are heading toward a major correction in the market.” The correction occurred between the beginning of April and the end of May 2000 when the NASDAQ composite index dropped from around 5000 to around 3200. During an interview with the magazine Milano Finanza (May 22, 2000) I suggested that the correction presented an opportunity for investors to buy selective stocks. An investor who bought the stocks I recommended during that same week made a substantial return on his investment. At the end of May, many financial analysts were concerned about the NASDAQ index around 3200. On the week ended June 2nd the NASDAQ index shot up about 20%. This is the kind of volatility I have been predicting in our newsletters since the end of 1999. With oil prices around \$30 per barrel and increasing inflation pressure, we think the Fed will increase interest rates an additional 0.25% to 0.50% before the end of this year. In a front-page article (Zero-Sum Gain) dated March 3, 2000, *The Wall Street Journal* reported “*Layoffs, which normally fade during boom times, remain widespread.*” Stock market bubbles and high volatility will continue until we have another major correction. I do not see how price pressure in the job market will bring productivity in line with salaries. Right now in Northern California, approximately 35% of people cannot qualify to buy a house. With an additional 0.50% increase in interest rates, the real estate market is sure to be headed for a tumble. History is repeating itself. When salaries fail to keep up with increases in productivity, the stock market must correct. With an increase in interest rates, lower salaries, higher productivity, and increases in oil prices, the stock market correction will be more severe.

Major countries such as Brazil, Argentina, India, and China will suffer most. China (excluding Hong Kong) already has a troubled banking system which is virtually bankrupt, and its manufacturing sector is in a downward spiral of falling prices and overproduction. The decrease of growth in China’s GDP has gone from around 14% in 1992 to around 7% in 1999. Even 7% in growth would leave China short of the 8% growth the government needs to create the 20 million new jobs necessary to satisfy new job seekers every year. Any additional increase in interest rates will create an environment of stagnation and inflation. This in turn will create major political problems for the Chinese government.

A bear market gives investors plenty of time to make decisions. Major declines generally take months to seriously encroach on prices. Bear markets usually develop out of a confusing and complex top formation, and the first correction is seldom seen as dangerous. For example, the April-May, 2000, NASDAQ index correction (from around 5000) of about 30% rebounded in a short period of time to 4,200. It is very difficult to time the market. I will attempt a forecast for the next six months. **I believe that we will have another major market correction from recent levels sometime between the end of September and the end of November, 2000.** By “major correction” I mean a 25% to 40% correction from current levels. After the correction occurs, investors will have the opportunity to buy selective stocks at a considerable discount. In a bear market, unless you want to lose your shirt, I recommend that investors be very selective and maintain at least 50% in a U.S. Treasury money market.

The Stock Market

We are selective in buying stocks and suggest that investors proceed with caution. We suggest that investors maintain at least 50% in cash or equivalent. Now more than in the ever, we have to focus on companies that will emerge as leaders after the market correction. These companies have both the best technology available and the best management in their field of operation. Biopharmaceutical stocks are now and will be more volatile than the market. The risk involved in making investments in these stocks is greater than old economy stocks, but the opportunities for reward are also higher.

This month we are adding two companies to our recommended list.

The first company is: **Biolase Technologies (NASDAQ: BLTI)** The Company designs, develops, manufactures, and markets laser-based systems for use in dental and medical applications. The current generation of the Company's lasers-based systems incorporates its proprietary HydroKinetic technology into its surgical tissue cutting system called Millennium, which utilizes electromagnetic energy laser pulses from erbium, chromium: yttrium scandium gallium garnet ("Er,CR:TSGG") laser and a proprietary water spray. The laser has been cleared by the FDA to market for a broad range of dermatological and general surgical soft tissue applications. The company is already selling its products to dentists around the world and in so doing it is building a sales force. Besides the U.S., BLTI is selling to an additional 21 countries. Their marketing target is to sell to about 5% of the world's dentists. Since the product is far superior to the drill used today in dentistry, I think that many dentists will choose to utilize this new technology. The only obstacle to major development is the price tag of the machine. By looking to serve about 5% of the market, the company is developing the right strategy. BLTI should achieve a break even by the end of fiscal 2000. *The stock is trading around 2 1/4. My target price for the next 12*

months is around \$5. We have a position on this stock.

The other new company added to our recommended list is **NicOx**. The company is listed at the **Nuveau Marche' in France** under the stock code 7413. NicOx's innovative approach harnesses the beneficial properties of nitric oxide grafting a nitric oxide-releasing structure onto existing drugs and has already begun Phase II trials in patients with neurogenic bladders in July 1999. It is scheduled to begin phase II trials in patients with Paget's disease. NicOx's pipeline includes a broad range of new chemical entities protected by patents in major markets. By beginning with a conventional drug whose pharmacological properties are well known, NicOx benefits from an existing base of knowledge from which to design pre-clinical and clinical development studies. This enables evidence of efficacy and reduced side effects to be confirmed very early in clinical development, and in some cases by the end of Phase I, thereby shortening the overall product development cycle. In pre-clinical tests, NicOx drug candidates have shown dramatically reduced side effect profiles compared with the parent drugs. In many cases the drug has shown the potential to be more effective. The agreement between NicOx and AstraZeneca gives AstraZeneca an exclusive license for HCT 3012 and selected nitric oxide-releasing NSAIDs for the treatment of pain and inflammation. The pipeline includes other nitric oxide-releasing drugs to treat a range of indications including inflammatory bowel disease and respiratory diseases such as asthma. In the last twelve months the stock traded as low as Euro 24 and as high as Euro 126. *Now it is trading around Euro 69. My target price for the next twelve months is around Euro 87.*

Our stock list update.

Health Care

Valentis (NASDAQ: VLTS). Its Del-1 gene medicine elicited development of new blood vessels in pre-clinical animal studies. These

studies were reported at the American Society for Gene Therapy's Third Annual Meeting in Denver, Colorado. The Del-1 gene medicine is being developed for therapeutic angiogenesis in patients with peripheral vascular disease and coronary artery disease. Initiation of clinical studies with Del-1 gene medicine is projected for the fourth quarter of 2000 in patients with peripheral vascular disease. Valentis' modular gene delivery, gene expression and manufacturing technologies provide the basis for rapid translation of targets identified through genomics research into new biologic therapies. Its proprietary plasmid-based Factor IX gene medicine demonstrated correction of bleeding in a large animal model of hemophilia following a single administration of the therapy. The Factor IX gene medicine, consisting of a DNA plasmid containing the Factor IX gene formulated with one of Valentis' proprietary PINC polymers, is a non-viral product administered by intra-muscular injection. Expression of the therapeutic protein is enhanced by electroporation, the application of a small amount of electricity at the site of injection for a few milliseconds. In addition, regulated expression, after a single administration of the Company's erythropoietin gene medicine controlled by the Company's GeneSwitch, was shown for up to one year. *VLTS stock is trading around \$8 1/2. Our target price for the next 12 months is around \$14.* We hold a position on VLTS.

Aradigm (NASDAQ: ARDM)

The Company reported revenues of \$5,700,000 for the quarter ended March 31, 2000, compared with \$3,586,000 for the same period in 1999. Total expenses in the first quarter of 2000 were \$12,969,000 compared to \$9,196,000 in the first quarter of 1999. The net loss recorded in the first quarter of 2000 was \$7,195,000 or \$0.48 per share, compared to a net loss of \$5,479,000, or \$0.43 per share, in the first quarter of 1999. As of March 31, 2000, cash, cash equivalents and short-term investments totaled \$25,727,000. At the end of April, the company has about \$70 million in cash or equivalent. Reading the most recent studies by Novo Nordisk, the world's leading insulin company and Aradigm's partner, we believe that ARDM AERx system's

efficiency will be in a competitive position to deliver insulin by inhalation using the AERx system. The stock is trading around \$12 1/8. *Our target price for the next 12 months is around \$23.* We hold a position on ARDM.

Advanced Tissue Science (NASDAQ: ATIS)

ATIS is a tissue engineering company utilizing its proprietary core technology to develop and manufacture human-based tissue products for tissue repair and transplantation. The first application of the Company's tissue engineering technology is for skin wounds and includes Dermagraft for the treatment of diabetic foot repair of cartilage in knee joints. The Company also has a strategic alliance with Inamed Corporation for the development and marketing of several of ATIS' human-based, tissue-engineered products for aesthetic and certain reconstructive applications. I think this technology could be included in the cosmetic market, and has the potential for increasing the Company's revenue in the near future. *ATIS is trading around 6 5/8. We recommended the Company in May when it was trading around \$4. We raise our target price for the next 12 months to around \$9.*

Genome Therapeutics (NASDAQ: GENE)

Total revenues for the third quarter of fiscal 2000 were \$6,477,526, compared to \$6,302,475 in the same period of fiscal 1999. Net loss in the third quarter of fiscal 2000 was (\$889,056), or (\$0.04) per share, compared to a net loss of (\$1,627,698), or (\$0.09) per share, for the same period in fiscal 1999. The Company's cash, cash equivalents, at the end of the third fiscal quarter of 2000 totaled approximately \$31,667,000 compared with \$25,062,000 at the end of the prior fiscal year, August 31, 1999. *I first recommended GENE in December 1998, when the stock was trading around \$2 1/2. It has traded as high as \$79. Now the stock is trading around \$22 1/4. We bought a position on GENE at \$3, then we sold it at \$16. We repurchased GENE at \$14 5/8 and sold it at \$26 5/8. This company is a winner. Our target price for the next 12 months is around \$36.*

SciClone Pharmaceuticals (Nasdaq: SCLN).

Revenues for the second quarter of 2000 from sales of ZADAXIN, SciClone's lead immunotherapy, were \$4,206,000, an increase of 110% over the same period last year and 20% over the previous quarter. This is the tenth consecutive quarter of double-digit ZADAXIN sales growth. For the quarter, the Company reported a net loss of \$589,000 (\$0.02 per share), a decrease of 61% compared to a net loss of \$1,511,000 (\$0.07 per share) for the same period in 1999. Revenues from sales of ZADAXIN for the six months ended June 30, 2000 were \$7,705,000, an increase of 115% over the same period last year. Net loss for the six months ended June 30, 2000 was \$1,464,000 (\$0.05 per share), a reduction of 65% over a net loss of \$4,134,000 (\$0.20 per share) for the same period in 1999. Cash and investments totaled \$18,001,000 at June 30, 2000. *We first recommended SCLN in November 1998 at around \$ 1 1/4 . The last recommendation was in April, 2000, with the stock around \$10. Now it is trading around \$ 12. My target price for the next 12 months is around \$16.* We hold a position on SCLN.

Real Estate Investment Trust

Pacific Gulf Properties (NASDAQ: PAG). For the quarter ended March 31, 2000, Funds From Operations (assuming the conversion of all preferred shares) totaled \$15.7 million, or \$.67 per share. This represents an increase of 12% per share over the \$14 million, or \$0.60 per share, generated one year ago, due primarily to increases in same-store rents. Multifamily same-store net operating income increased 11 percent from one year ago. Net operating income, or gross rental income less rental operating expenses, for the first quarter of 2000, was \$24.9 million on revenues of \$32.9 million, compared with \$22.1 million on revenues of \$29.7 million for the same period in 1999. This represents a 13% increase for the Company. The stock is trading around 25 ½, and the dividend is around 7%. *Buy it under \$23. Our target price for the next 12 months is around \$26.*

Glenborough Trust (NYSE: GLB). Comparison of the three months ended March 31, 2000 to the three months ended March 31, 1999. Rental Revenues. Rental revenue decreased \$1,480,000, or 2%, to \$63,161,000 for the three months ended March 31, 2000 from \$64,641,000 for the three months ended March 31, 1999. The decrease included decreases in revenues from the industrial, retail and hotel properties. These decreases are primarily due to the sales industrial, retail, and hotels since March 31, 1999. These decreases are partially offset by increases in revenue from the office and multifamily properties. The company has a well diversified portfolio of prime properties. GLB has a shares repurchasing program. We bought series A preferred shares at an average price of \$15 ¾, with a yield of about 12.7%. The common stock is now trading around \$18, with a dividend of around 9.7%.

Indexes: DJI 10685.12 – NASDAQ 3981.57 - Russell 2000: 514.25 – Microcap1000: 1551.69

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