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Overview

Is there an end to corporate raiders, or if you prefer, corporate *robber barons*? A comparison to the past is appropriate. However, were we to compare the United States robber barons appearing at the end of 1800s and beginning of 1900s to today's corporate raiders, I think we would find substantial differentiations. The original robber barons were risk takers, even if they got free land from the government to build infrastructure such as railways, electricity transmission lines and grids. Today's robber barons come from pampered universities and were handed a company to run on a silver platter. The old barons risked their shirts to build infrastructures that ultimately benefited America. The new barons operate safely behind their desks with bankers' money and utilize fraudulent accounting practices. The old barons were entrepreneurs, while the new ones are bureaucrats -- cheating everyone from employees to bankers, and ultimately the United States. If the old barons went bankrupt, it wouldn't have jeopardized capital markets around the world. But the new robber barons are disrupting capital markets worldwide. The dollar's value went from around 85 cents per Euro down to \$1 per Euro within few weeks. In the U.S. stock market, over one trillion dollars has been lost over the past 3 months. Recent and former executives of these corporations took home millions in paychecks with no risk. The Bush administration and the Congress have been far too lenient with these crooks. They should be put in prison for at least 20 years without parole and stripped of all their assets. Perhaps their assets should be distributed to shareholders and employees alike.

The Congressional Budget Office said in its August monthly review that after 10 months of the current fiscal year (which ends in September) the government was running a deficit of \$150 billion, a sharp reversal from the \$172 billion surplus recorded over the same period last year.

The CBO's projection was broadly in line with those of the government and private analysts. The White House budget office in July forecast the government would run a \$165 billion deficit this year. The dollar's rally to a six-week high against major European currencies and the yen was fueled in part by expectations that the Fed would cut rates in a bid to boost flagging economic growth. However, as expectations for a cut diminished ahead of the meeting, the dollar's rebound stalled. Now let's speculate on interest rates and the economy. The Federal Reserve meeting today left the fed funds unchanged at 1.75%. This will not affect the economic trend. I do not think that the economy will recover before the end of this year. If we see improvement, it will happen most likely during the first quarter of 2003. I wrote this forecast in my February 2002, newsletter and I stand by it. So far, it has been one of the most accurate long-term forecasts of the U.S. economy.

Europe

The European Union has its own problems. In Germany there will be a new election this year. The economy there is not good, and their union members are restless. New long-term strikes by workers appear a near-term possibility. Not too much change is expected in France or Italy

until September. In any event, all the countries (with exception of the U.K.) in the EU and Ireland are heavily bureaucratized. It is as though business is bound up in a straight jacket. The welfare state is draining precious resources from active and profitable companies and individuals and transferring them to welfare recipients. A productivity there lag behind the U.S. and the population is getting older. I do not see much upside on the Euro.

South America

The IMF's recent \$30 billion loan to Brazil is yet another drop in the sea of emerging market debts. It has been proven time and time again over the past 30 years that making loans to governments that cannot manage their internal affairs does not resolve their problems. Argentina is the most recent example where a corrupt government wasted billions of dollars. The U.S., European investors, and taxpayers footed the bill. Here we have an old class of robber barons: government officials. Those are the worst of all robbers because they literally brought a country down to its knees. They deserve to be heavily punished by their own countrymen. The only solution for their financial woes is to invest directly in these countries and make loans to private companies. If corrupt government officials are on the take, they should be punished internationally by exposing their scam to the public. There are serious entrepreneurs and honest workers in those countries that need our help. But their government officials do not appear to deserve it

The Stock Market

If investors buy stocks now based on the strength of analysts' estimates of S&P 500 earnings for 2002, I predict they are in for an unpleasant surprise. The index is currently trading at a projected price/earnings ratio of 21, based on analysts' estimates of operating earnings for component companies. The 2002 P/E is 40% higher than the average multiple for the index over time and sharply higher than the S&P's multiple in other bottoming periods. In

the 1990-91 recession, the S&P 500 traded at a 14 P/E and in the 1973-74 bear market, at 7. As we know, the earnings performance for 2002's first half is a sorry one. Company after company has been forced to lower expectations or to restate past results downward. How can the consensus justify such a healthy-looking multiple for the year as a whole? By forecasting a second-half profit boom that comes up from nowhere is like a mad dream: a 48% gain (from a year earlier) in the third quarter, 45.7% in the fourth, according to S&P analysts' forecasts. Included in the forthcoming profit explosion, as reported in First Call, is a 127% income increase in technology stocks in the third quarter and a 73% jump in the fourth. Those forecasts are frightening. I think we will see a modest increase in earning in the third and fourth quarters. The real estate market is holding up well in this environment and my leading indicators now are: the real estate and construction indexes, employment figures, the flow of investments in and out the U.S., and import/export data. In addition, in the third and fourth quarters I will look closely at results coming from political elections in many states, and in Germany. As stated before, I do not believe that economic recovery will come before the fourth quarter 2002 or the first quarter of 2003. This summer's short rallies, have the effect to favor hedging strategies. I think the NASDAQ will go again around 1200 and the DJI around 7000 - 7500. If my favorite leading indicators hold up well, we shall see the recovery of the economy by year-end, with the NASDAQ at around 1400, and the DJI at around 8500. Otherwise we will have the NASDAQ at around 1000 and the DJI around 6000 and the economy in deep recession. I am more incline for the first scenario.

I mostly follow the life sciences market. This market has fluctuated and will continue to fluctuate for the following reasons:

- 1) Big pharmaceutical companies will continue to dominate the market, but they do not have the pipelines to sustain a 15% to 20% growth

per year. Therefore, they have to increase investing in small biotech firms and/or keep doing the same mergers and acquisitions between them. I believe that the recent merger between Pfizer and Pharmacia will prove to be a mistake. The way to enhance shareholders' value would be to do spin-offs of their divisions to become "lean and mean" to compete in the market. Large pharmaceuticals are mostly bureaucratize therefore, slow in developing innovation.

2) Medium-sized companies manufacturing generics are my favorites because:

a) Politics: Due to political pressure from an aging population, politicians would like to lower the costs of prescription drugs. A new law on patenting has just passed. Many big pharmaceuticals will not have the chance to increase the terms after a patent expires.

b) Some generic companies have a patented pipeline of their own.

c) Streams of revenue. Margins are lower than patented products but generics sell also during an economic recession.

3) The nutraceutical sector after sustain major losses is in transformation to new "Nutra-Pharma" products. New systems of nutraceutical and drug delivery are developed and new clinical trials are underway to prove that these products are an alternative or integration to some type of drugs or healing programs. Just think about probiotics and you will find few but interesting discoveries.

4) The med-tech sector is one of the best performing in this market. New investments will flow when the majority of investors understand the importance of this sector, which in my opinion has being undervalued. We need new diagnostic tools for better health.

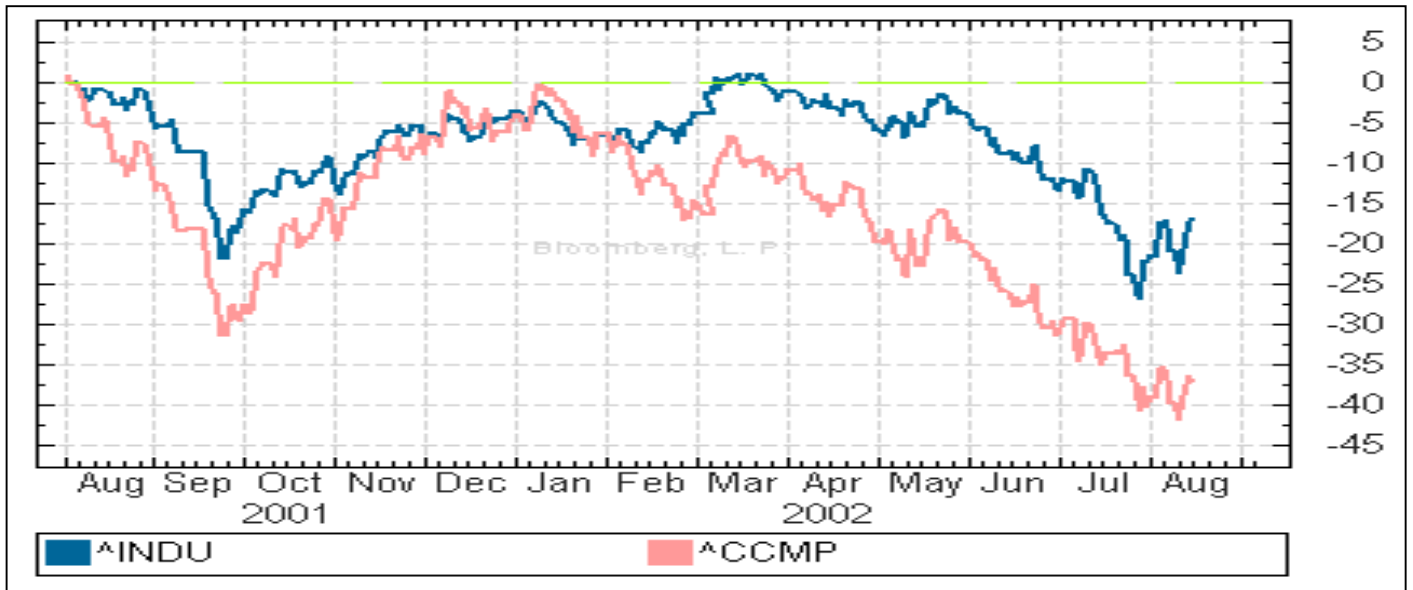
The sector with the most risk and highest reward is the ultimate frontier: the brain. Investments in this sector will increase dramatically in the future.

Conclusion: Investors should be diversified with core holdings in generic, med tech and small to medium-sized companies, which will bring in the multiple necessary to beat inflation and taxes. Using various hedging techniques for your stock holdings is a plus. This is the asset allocation I suggest to investors today: 50% to 65% in cash and short term AAA bonds. The remaining 35% to 50% in shares of Utilities and Energy (10%), Gold (5%), Life Sciences (50%), REIT's (10%), Food (5%) Financial Services (10%), and High Tech and Media (10%). We are heavy in life sciences because in the long run this is a recession proof sector. Of course when the entire stock market tumbles also the life science sector tumble. That is because "market timing" is very important, and stock hedging helps during market downturns. I am not for leverages and being 100% invested in the stock market. History has proven that the best long-term investors are balanced investors.

We are constantly updating our preferred list of life sciences stocks. Here is the new list:

ASTM, ARDM, ATIS, AVE, BRL, CEGE, CYTC, DNA, GSK, HGSI, DVSA, CEPH, CHIR, ITMN, IVX, KG, MEDI, NicOX (Niveau Marche' France), MLNM, MYGN, NBIX, NTEC, PPDI, PTLTO, RGEN, SCLN, SRA, and WPI.

Indexes: DJI 8,482.39 - NASDAQ 1,269.27 - S&P500 884.20 - Russell2000 379.70



Dark blue chart is for DJI and the second is for NASDAQ – Source Bloomberg LP

Dario A. Bianchi

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Post Office Box 27736 • Fresno, CA 93729 - USA • Tel: (559) 431-6860 • info@sienafinancial.com