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Overview

Most money managers spend more time conducting analyses of computers and semiconductor and financial companies, than on food production, forest management, sustainable energy, and related industries. Although we love computers, we can live without computers. We cannot, however, live without food, trees, and energy. Every economist is concerned with money supply, inflation and employment. I am most concerned about foods, health and energy. Cereals are the staple food for humans. The United States, Canada, and Argentina are among the largest producers of cereal in the world. China and India are the largest producers and consumers of rice in the world. World production of cereals has been flat since 1991 (source USDA). In 1997, a world grain harvest at 1.69 billion tons was 5 percent below the 1990 harvest of 1.78 billion tons. China, which had been a net exporter of rice since 1992, became a net importer. Grain used for feed in China went from 14 million tons in 1960 to 100 million tons in 1997 (source USDA). Kazakhstan, once producing and exporting nearly as much grain as Australia, may soon be struggling to feed itself. Africa's production of grain cannot sustain itself.

Perhaps one of the most underrated issues facing the world is increasing water scarcity. Water tables are declining on all the continents. It is only a matter of time before some major aquifers are depleted. Irrigated areas in Texas have declined about 11 percent after peaking a decade ago as the southern shallow aquifer of the Ogallala is depleted. Fertilizer is agriculture's most important item. From 1950 to 1990, the world's farmers increased use of fertilizers from 14 million tons to 146 million tons. This seems to be peak usage -- from 1990

to the present there has been no increase. Environmentalists and scientists warn that the current population trend cannot be sustained. *In a sustainable economy, births and deaths are in balance, soil erosion does not exceed the rate of new soil formation, tree cuttings do not exceed tree planting, and the number of fish caught does not exceed the sustainable yield of fishing.* Within the next ten years, we will witness an increase in food deficit in densely populated countries. Many European countries now have a stable population, but many Asian and American countries still have increasing populations. Also, the quality of foods is declining. Fish farming is becoming like chicken farming. It has led to the use of hormone treatments and diseases that require the increasing use of antibiotics.

Consider basic needs. With the population at over 5.2 billion people and growing, the earth's surface needs to be managed carefully. If we keep managing agriculture and forests the way we have in the past, we cannot sustain ourselves. Disruptive weather patterns are phenomena that are becoming more frequent, destroying crops. Food prices have increased more than the Consumer Price Index in the last five years. I believe that most of today's food prices are likely to increase in the near future. We need a program for sustainable agriculture, forest and energy management.

Now consider the growth of the global trade for U.S. multinationals. The U.S. Treasury Department released the following data: Cross border investment, both inflows and outflows, has grown dramatically in the last 40 years. In 1960, cross border investment represented 1.1% of GDP. In 2000, it was 15.9% of GDP, or annual cross border flows of more than \$1.5

trillion. The aggregate cross border ownership of capital is valued at \$15 trillion. Consider the role of U.S. multinational corporations in the economy. They are now responsible for more than one-quarter of U.S. output and about 15% of U.S. employment. At the same time companies are competing for sales, they are also competing for capital: U.S. managed firms may have foreign investors, and foreign-managed firms may have U.S. investors. Portfolio investment accounts for approximately 2/3 of U.S. investment abroad and a similar fraction of foreign investment in the U.S. The importance of capital markets is evident, as well as the need to have a sustainable economic growth policy.

The real world and the financial market

It seems to me that the new generation of Wall Street analysts is not interested in the broad energy sector except for the oil industry. How about wind power and solar energy? Wind power is poised for explosive growth using new, highly efficient wind turbines to convert wind into electricity. In the United States, the wind potential of states such as North Dakota, South Dakota, Minnesota, Texas and California could easily meet most of the needs of our nation. In Europe, wind power could theoretically satisfy 50% of current electricity demand.

Most markets are cyclical, but food, forests and energy are not as cyclical as many people think. Within the last twenty years, tremendous changes in population and systems of governance have introduced many new factors into the world market. Economic ups and downs, panics, bottoms, and depressions have occurred regularly for the last 250 years. In truth, the market crashed in the past two and one-half years. All market economies oscillate, with fifty years of long waves that bring, among other things, financial turmoil (such as in the 1930s). Oscillations in the market are inevitable. During the 1980s and 1990s there was an explosion of mergers and acquisitions, stock futures, index arbitrage and derivatives. Fancy financial instruments, which

more closely resemble gambling than investing, have detached the real economy. We now have about \$35 TRILLION in the global derivative market. The world financial markets are now controlling more wealth than all the world production of goods and services. Real wealth is stagnant. Where are we going from here?

Global Bureaucracy

IFM bureaucrats want to control the flow of money. The IMF was wrong in the 1970s, in the 1980s and in the 1990s, to reschedule debts of many South American and third world countries. It imposed austerity and heavy taxation on Argentina, Brazil and other countries. The result has been inflation, currency devaluation and rising unemployment. South America is looking more and more like Africa. The cure was a harsh dose of medicine that could have killed the patient. Those bureaucrats will never admit they were wrong. Originally, the IMF was set up to monitor and advise the development of nations around the world. In 48 years, the IMF has become the arrogant global rescue bureaucracy of developing nations, and that of developed nations today as well. The IMF would like to standardize the world financial systems and make it one, with one government.

The Financial Market

At the last meeting of the Federal Reserve Board's Open Market Committee, federal officials elected to keep their target for short-term interest rates at 1.25%. The yield for the 10-year U.S. Treasury note is about 4%. November retail sales, an early indicator of the level of U.S. holiday spending, rose 0.4%, in line with expectations. Compared with November 2001, sales were up 2.1%. Oil and gold prices are rising, the dollar is declining and near the three-year low. The Conference Board said the index of leading economic indicators rose 0.7 percent in November, the largest increase since a 1.1 percent jump in December 2001. Even with unemployment slightly higher, the positive effects of the recent

mortgage refinancing boom and historically high home sales are keeping the economy rolling.

Life Sciences

Experts see a rosy future for major pharmaceutical companies, provided they are willing to make fundamental changes in the way they've been doing business for the last 50 years. To reach that rosy future, big pharmaceutical companies must undergo radical mind-set changes from how they conduct R&D and clinical testing, including sales and marketing strategies for their future products. Due to the development of new medicines, medical instruments and new drug delivery systems, I think that in the next five years the industry is poised for new strong development. As I wrote many times in the past when describing the future of medicine, the industry is ripe for a dramatic shift toward medicines based on biology rather than chemistry -- a move away from so-called "one drug for one disease." Multiple compounds or "cocktails" will dominate the market. Biological drugs, nutraceuticals, and new drug delivery systems, synergistically working together will play a key role in health care. This could help eliminate often toxic side effects for the enormous number of people now being prescribed drugs that ultimately don't work for them. The industry will produce drugs that actually modify or cure diseases rather than providing palliative treatments that alleviate symptoms as in the case of Alzheimer. To achieve the above results the industry's major players will have to resist intense pressure from Wall Street and shareholders to consistently boost profits each quarter. This is not an industry to be judged by quarters, but rather, by years of performance.

About 35 of the industry's blockbuster drugs with global sales of over \$73 billion a year will go off patent between 2002 and 2007, and there are not enough blockbusters. This is good news for the production of generics. The pipeline to replace the revenue is in the making, assuming that funding continues to flow to the

small and medium-sized biotech firms. Next year opportunities to invest in micro and small cap companies will be higher than this year. The industry is dramatically

reducing the time drug discovery from an average 10 to 12 years in the 1980s to 4 to 5 years today. High tech is meeting biotech in a very fast way. Over the past five years, computers have changed the discipline—as they have harnessed the data on genetics for the pursuit of cures for disease. Welcome to the world of bioinformatics—a branch of computing concerned with the acquisition, storage and analysis of biological data. Once an obscure part of computer science, bioinformatics has become a linchpin of biotechnology's progress. In the struggle for speed and agility, bioinformatics offers unparalleled efficiency through mathematical modeling. In the quest for new drugs, it promises new ways to look at biology through data mining. As I wrote in one of my past newsletters, within 10 years the life sciences industry integrated with the high-tech industry will employ 20% of the workforce in industrialized countries.

What to do

Economic recovery is contingent on the following conditions: Oil prices should not exceed \$30 per barrel. The price of gold should not exceed \$350 per ounce. The war with Iraq should not occur, and if it does, it should be short lived. If the aforementioned three events occur and prices of oil and gold go above my target prices (and stay for a period of about 90 days), the dollar will fall dramatically and the economy will go into a major recession -- even a depression. On the economic front there are not too many things that the U.S. government can and will do next year. For instance, the repeal of double taxation for corporations will be a stimulus for the economy. To balance the shortcoming in tax revenue, the government could impose on corporations the distribution of at least 50% of their net profit to shareholders. In turn shareholders would be paying taxes and reap

the benefits that executives now are enjoying. In addition, government spending should be kept in check. This normally doesn't happen. Taking the above variants into consideration, I forecast a slow recovery for the first quarter of 2003 in the U.S., and a second or third quarter recovery in Europe if the dollar would not fall below \$1.08 per Euro. I kept our investment hedged and our model portfolios invested in 50% stocks and 50% money market and short term bonds. I increased the stock position from around 35% to around 50%. The following is our asset allocation: 7% in gold stocks or gold mutual funds, 20% in REITs, 50% in life sciences, the remaining 23% in miscellaneous stocks, or mutual funds. We increased the holding in Euro and British Pounds to about 40%, and the rest 60% in US dollars.

Preferred stocks list:

Life Sciences: ASTM, AVE, BRL, CEGE, CRL, DNA, DVSA, CEPH, CHIR, GENZ, GSK, GILD ITMN, KG, MATK, MEDI, NicOX (Niveau Marche' France), MLNM, NTEC, NBIX, PPDI, PTI.TO, RGEN, SCLN, SYT, and WPI. REIT's: GLB preferred shares, HCP preferred shares and SHU preferred.
Our preferred list of mutual funds:
BGRFX, PBFOX, OAKGX, RYSEX, VGENX, VSEQX, VGSTX.

Indexes: DJI 8,493.29 - NASDAQ 1,381.68 - S&P500 897.38 - Russell2000 389.73- Amex BTK 359.77
10-Year Treasury Bond 39.67 – U.K. FTSE 100 3,936.90

HAPPY HOLIDAYS

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