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Overview

Enough is enough! We are being flooded with news about companies that either cook their books, or have resorted to “creative accounting” practices. The Enron case is the worst. The company, besides losing shareholders’ money, impoverished thousands of workers because it did not allow vested employee stockholders to sell their stock deposited in their retirement plans. Another story is about Ireland’s largest bank, Allied Irish, where a rogue trader defrauded the bank of an estimated \$750 million. Greed can be good and greed can be bad. The problem happens when a person develops an appetite for power and money. If the individual lets the power overrule common sense, an idiotic form of greed develops. When this happens, all sorts of twisted thoughts (and actions) prevail. Enron is a classic example of that happening. Since then, we have heard bad news about companies such as Tyco International, Elan Pharmaceuticals, with its stock falling about 50% in one day, and minor news and rumors about others. Hold on a minute! Have I not written many times that this entire frenzy merger and acquisition by huge companies is negative for the market? The U.S. economy is healthiest when small businesses flourish, not because of big business. Of course, we know that large corporations have channeled huge amounts of money to Washington, D.C. and Sacramento. Special interest is the name of the game.

Now let’s take a look at where we are today and where we are going.

National and International Debts

According to the Federal Reserve, despite low interest rates, the debt-service burden of American households now amounts to almost 14% of their income. The low inflation illusion

is that low interest rates mean less debit-service burden. This is not working because we have increasing unemployment and increases in net debt. It will be difficult now for the Fed to further lower interest rates. Layoffs and the stock market plunge have forced Americans to take a cold, hard look at their financial assets and cut back on spending. According to National Foundation for Credit Counseling, debtors seek help from the NFCC, because they already owe \$18,000 on average, although some clients are as much as \$200,000 in the red. Japan is the prime example where a mountain of debt has kept that country in recession for 10 years. Deflation and a shrinking nominal GDP are swelling the real burden of both private and public sector debt. Historically, Japanese households have been one of the world’s biggest savers, but they are now the world’s biggest borrowers with about 132% of their income from loans. Europe is in slightly better condition than the U.S. and Japan. Due to red tape, welfare spending, and high taxes, businesses have major obstacles that impede rapid development. The German government is under immense pressure. Germany is trying to increase spending, but it is causing tension in the Euro zone.

The latest developments in Argentina don’t look very good. I think Argentina is going to go through a major cycle of inflation, or worse, stagnation and inflation. Unfortunately, increased borrowing worldwide has blinded central banks. The equation of price stability and growth was built under a mountain of debts. Now, the day of reckoning is approaching. We think inflation will be here soon. We forecast real inflation of 4% to 5% by the end of this year.

What To Do?

What does this mean for investors? On one hand, it means that investors will have the opportunity of a lifetime to buy some high quality stocks at 70 to 50 cents to the dollar. On the other hand, it means there will be increasing losses in the market. Recovery will come, but it will be not before the end of 2002 or Spring 2003. It is possible that this might be delayed until Summer 2003. It depends on how all these debts were serviced or restructured and whether companies re-establish accounting practices investors can trust. The credibility of companies has been severely damaged, resulting in a very nervous market.

This will delay economic recovery even further. We are keeping between 50% and 70% of our portfolios in money markets. The remaining, we are investing in selective stocks. We also use options to protect our portfolios.

A Word On Life Sciences

Investors are trying to define the strategy on how to invest in this sector. We would like to point out the following: The incredible level of functional complexity revealed as we decode and decipher the human genome should not come as a surprise. New molecular tools only confirm what we have already guessed—all life on Earth is part of complex systems, from the biosphere to social network down to the cellular and molecular levels. If investors think that now there is a much easier pathway to drug discovery, think twice. We have more sophisticated instruments--from diagnostic to drug development tools--than ever before. At its simplest, the genomics discovery has only given us a list of biological components. Only by understanding the functions of gene products within the cell and tying them to biological processes can we determine what is possible to manipulate for pharmaceutical candidates. This process will take a lot of time and money. Today proteomics is in vogue in industry and the media. Unfortunately, it risks disappointing the pharmaceutical industry for many of the same reasons as genomics—by ignoring underlying biological complexities. The pathway is exciting but it will be long time before we achieve substantial results in this area. Through this endeavor, we know that the brain is the last frontier.

The following is a list of companies we invest from time to time.

ABGX, ABI, AGEN, AKZOY, ATIS ARDM, AVE, CEGE, CEPH CHIR, CRA, COR, CORR, DVSA, DNA, GENZ, GSK, HGSI, KG, ITMN, MAXY, MEDI, MEDX MLNM, MYGN, NicOX (Nuveau Marche' France) NTEC, PPDI, RGEN, SRA, VLTS, WPI

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