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Predicting the economic outcome is very difficult during times of uncertainty such as these. Last July, when I correctly forecasted the coming recession and downfall of the stock market, I was not thinking about a terrorist attack. Natural disasters occur sometimes, but life goes on. We rebuild houses and reopen for business. When uncertainties occur (in this case a terrorist attack) we can't be sure what the future will bring so we must act more prudently. The problem now is: will this economic recession turn into a depression? Let us analyze the current economic picture. The Fed, The Bank of Japan, and the European Central Bank, are flooding the markets with a huge amount of liquidity. Estimates in the last two months run into the billions. I think we are close to \$300 billion. On one hand, this huge amount of cash will keep many major corporations and financial institution's solvent. Unfortunately, we have many new developments that don't match the recent stock rally. Do you remember the collapse of the Long Term Credit Management edge fund? At that time (October 1998) the Fed injected billions into the system. Now Enron has gone bankrupt leaving much uncertainty in the financial arena, Argentina with over \$134 billion in unpaid debts, and the rest of the emerging markets losing exports to the U.S. Above all, the telecoms overbuilt and overspent and we have ever-increasing bankruptcies such as @Home most recently. We've all now heard a great deal about why these companies stumbled and why their shares plunged: exorbitant overbuilding fueled by too much venture capital; overcapacity; resulting price wars; bankruptcies of customers. But now that's history. U.S. jobless rates went from 4.5% in July 2001, to nearly 5.6% now. In addition, the war on terrorists will dramatically increase government spending. Nevertheless, America is going to get a fiscal

stimulus. Fiscal easing from tax cuts equivalent to 0.6% of GDP was already planned before September 11th. Now a further package with a total of up to \$130 billion (over 1% of GDP) may be added, tipping America's budget from surplus to deficit. On top of extra defense spending and emergency disaster relief already approved by Congress, there is strong support for more spending and tax cuts. On the bright side, we also have all central banks reducing interest rates. Of course, this should keep the economy on sound ground, assuming that consumers and investors alike resume their spending and investing. With the reduction in interest rates, the U.S. government is reducing the amount of money it needs to service the national debt. This in turn should keep the cost of borrowing low. This is our opinion. For example, in the last thirty days the 10-year treasury bond yield is steady and did not decrease in tune with the reduction on short-term interest rates. The market is telling us that next year we will be hit with more inflation. This has always be the solution that governments throughout history have adopted to get out of recession or finance wars.

ECONOMIC sectors such as banking and real estate should do well, with the exception of some geographic regions such as the San Francisco Bay Area, San Diego, and other high tech areas of the U.S. The health care and life sciences sectors together with utilities are to a certain degree recession resistant. The real estate sector is the one to watch closely. If this sector doesn't deteriorate dramatically, then we will be on our way to recovery. Anxieties about personal and financial security as concerns over bio-terrorism rise may have begun to outweigh the appeal of lower mortgage rates and a drop in median home prices compared to August and year-ago levels,

economists said. Every company involved in the manufacturing of advanced security systems will be at the forefront of any economic recovery. In a fresh sign that the credit woes of companies worldwide have not abated, Standard & Poor said on Thursday that 41 issuers defaulted on \$31.3 billion of rated bonds in January. Both totals set records for a single month. Medium-term and long-term bondholders will suffer for these defaults and for the consequences of any inflationary outlook, and reduced interest rates. It is advisable to keep money in bonds such as Series I (inflation indexed) US Savings Bonds, or in bonds with a maturity of no more than two years.

JAPANESE banks have long been teetering on the brink of disaster. Over the past ten years there has been much talk about fixing them, and even occasional action. Yet bad debts have continued to rise. Now, in the aftermath of September 11, a further deterioration in Japan's economy, and with it the value of the banks' loans, has put reform back at the top of the agenda. The big banks have little capital left to cover fresh losses. Officially they have ¥23 trillion (\$192 billion) of core capital. More plausible estimates suggest that their true capital was closer to ¥10 trillion in March. Since then, plunging share prices have wiped out a further ¥5 trillion. At the same time, bad loans have continued to soar, not least because deepening recession is dragging ever more firms into trouble. According to official estimates, some ¥61 trillion out of ¥340 trillion of loans made by the big banks are to "problem borrowers." For the banks as a whole, loans to problem borrowers are officially ¥150 trillion; but a recent estimate by Goldman Sachs suggests that the true number could be as high as ¥237 trillion.

THE EURO area is also constrained by its needlessly restrictive "stability pact," under which budget deficits can exceed 3% of GDP only in exceptionally severe recessions. This rules out significant fiscal stimulus. Indeed, if governments were to meet their intermediate targets for 2002, set in the framework of the stability pact, fiscal policy would need to

be tightened in the Euro area by an average of 1.5% of GDP next year. But there are no penalties for exceeding these intermediate targets. So, thankfully, Europe's governments have said that they will set them aside and allow automatic fiscal stabilizers to work.

ARGENTINA: unemployment is around 20%, and about 2,000 people are dropping below the poverty line every day, I think that Argentina will devalue and inflate the market. There is no other solution in sight. Until the kleptocrat politicians of Argentina decide that it is time to change policy and get serious about reforms that are for the benefit of the country and not their pockets, there is no hope for the country. I just returned from a trip to that beautiful country. I found a major contradiction between the opportunities that Argentina presents and the country's financial mess that started with ex-president Menem, and it is not finished yet. In addition, the IMF cannot keep imposing the old austerity programs that produce only poverty and devaluations. The IMF has already been heavily criticized for allowing Argentina to rack up such heavy debts in the first place. Unfortunately, around the world, the IMF and its policies are closely identified with the United States. In the wake of the Argentine debacle, it's time for a serious reconsideration of the IMF and its policies. The default of Argentina, the biggest in history, is unlikely to trigger a global financial panic on a par with the emerging markets meltdown of 1997-98. Many emerging economies will suffer as a consequence of the default. Argentina needs a low-taxation system, encouraging capital and R&D investments that works, and gets rid of corrupt politicians. The government of Argentina is now taking the country into a massive devaluation and inflation. Back to the 1980's?

I THINK that the only way out of this mess is to inflate. We will not see too much inflation in the next ninety days, but in the next six to nine months. In 2002, inflation will be in the order of between 4% to 5%. Then with increased productivity we will have an economic recovery. If we do not have an increase in productivity,

then we will have economic stagnation and inflation.

The Stock Market

Between the end of 1999 and the beginning of 2000, the stock market was like a casino where gamblers not investors were placing their bets. Now things are the reverse of those times. Irrationality plus investors shortening the market are playing an important role. It is possible that the market will go down another 15% to 20% from today's depressed levels. The Amex Biotechnology Index (BTK) has underperformed the NASDAQ, DJIA, and S&P 500 by 9.3%, 8.8%, 9.8%, respectively, since its recent high in early December for a number of reasons. In 2002, I think the Amex Biotech index will outperform the three major indexes. In any event, I think that the NASDAQ index in the next sixty days will trade between 1800 to 2000. As usual, we suggest that investors to keep a good amount of money in money markets and short-term bonds with ratings of A or better.

Here is a list of companies we recommend.

Cell Genesys (NASDAQ : CEGE)

CEGE reported further clinical data from its multicenter Phase I/II GVAX lung cancer vaccine trial which demonstrated a complete tumor response rate of twelve percent and a median response duration of greater than 11 months in patients with advanced non small-cell lung cancer who have failed chemotherapy and/or radiation therapy. The multicenter clinical trial reported by Cell Genesys included 36 evaluable patients. The company pipeline includes: Oncology: phase II clinical trials in the lung, prostate, leukemia, and pancreatic cancer. Phase I in myeloma and two prostate (IT and IV) Phase II clinical trials. The company has about \$200 million in cash plus about 9 million shares of Abgenix valued at around \$270 million.

Pharmaceutical Product Development. **(NASDAQ : PPDI)**

PPDI provides a broad range of research and development and consulting services in two segments, development and discovery sciences. The company applies innovative technologies, therapeutic expertise and a commitment to quality to help clients maximize the return on their R&D investments. Net revenue for fiscal year 2002 is expected to be in the range of \$515 million, up 20% as compared to 2001 forecast net revenue of approximately \$430 million. Earnings per diluted share for fiscal year 2002 are expected to be in the range of \$1.13 to \$1.17, as compared to a forecast of \$0.94 for fiscal year 2001.

Regeneron (NASDAQ : REGN).

Regeneron's product pipeline includes product candidates for the treatment of obesity, rheumatoid arthritis and other inflammatory conditions, cancer and related disorders, allergies, asthma, and other diseases and disorders. All the above are large markets. The company utilizes its Designer Protein Therapeutics platform to genetically engineer product candidates. The first product is Axokine which acts on the brain region regulating food intake and energy expenditure and is being developed for the treatment of obesity. This product has been also developed in a pegylated form. The second product is Interleukin-1 Cytokine trap (IL-1 Trap). Is a protein-based antagonist for interleukin-1 (called IL-1) cytokine. IL-1 is thought to play a major role in rheumatoid arthritis and other inflammatory diseases. In July 2001, REGN initiated a Phase III clinical program of Axokine

The third product is a protein-based antagonist for the interleukin-4 and interleukin-13 (called IL-4 and IL-13) cytokines. These cytokines are thought to play a major role in diseases such as asthma, allergic disorders, and other inflammatory diseases. The other products under development are: protein-based antagonist to Vascular Endothelial Growth Factor, which is required for the growth of blood vessels that are needed for tumors to grow and is a potent regulator of vascular permeability and leaks. The last product under development is Angiopoietins:

A new family of growth factors that act specifically on the endothelium cells that line blood vessels. The company is partnering with Procter and Gamble, Medarex and Amgen. RGEN has \$435 million in cash and the net burn rate forecast is about \$25 million per quarter.

Diversa (NASDAQ : DVSA)

Diversa's technology platform draws on the combined advantages of natural and laboratory evolution to deliver superior products to a number of markets. Through its proprietary integrated technology, Diversa taps into the largest genomic resource on the planet: microbial genomics. Through the use of DNA extraction techniques, Diversa is able to access genetic material from uncultured organisms that account for over 99% of the Earth's untapped biodiversity. The company strategic partners are: Aventis Animal Nutrition, Celera Genomics, Dow Chemical, GlaxoSmithKline, Invitrogen, and Syngenta Biotechnology. For the fourth quarter 2001 DVSA reported revenues of \$10.0 million for the fourth quarter ended December 31, 2001, a 12% increase over fourth quarter 2000 revenues, and \$36.0 million for the year ended December 31, 2001, a 48% increase over revenues for the year ended December 31, 2000. The net loss was \$7.5 million, or \$0.21 per share, in the fourth quarter of 2001, compared to a net loss of \$0.4 million, or \$0.01 per share, in the fourth quarter of 2000. The 2002 forecast net burning rate is about \$20 million. Revenue should increase in respect to 2001.

NicOx (Nuveau Marche' : NCOX.LN or NICO)

NicOx is a leader in the research, development and commercialization of nitric oxide therapeutics. Nitric Oxide (NO) is synthesized in the cells of the human body and is involved in a broad range of biochemical and physiological reactions. The company has eight product in clinical development, in the following area: pain, inflammation, osteoporosis, urinary incontinent, dermatology, cardiovascular diseases, psoriasis. The company pipeline is a low risk investment opportunity due to the fact that NicOx develop new products using well known, common used compounds such as aspirin, flurbiprofen, naproxen, prednisolone, hydrocortisone, and acetaminophen.

Intermune (NASDAQ : ITMN)

The company has one product in the market: Actimmune (Interferon gamma-1b) which is a naturally occurring protein that performs two important functions in the human body. One is an antifibrotic activity, and the second it stimulates the human immune system to fight infection. Moreover, ITMN has relaunched Infergen (Interferon alfacon-1) for the treatment of chronic hepatitis C infections. Recently, the Company reported positive interim results from a Phase IV clinical trial comparing the use of Infergen plus ribavirin to the use of interferon alfa-2b plus ribavirin. This is about \$3 billion market of which about 50% could be targeted by Infergen. Forecast net operating burn rate for 2002 is \$110 million on revenue of about \$100 million. The cash position is around \$320 million.

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