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Overview

Reports from the United States Commerce Department show a slide in new U.S. housing projects and a persistent increase in the number of workers seeking unemployment aid. This is a signal that the U.S. economic recovery is stuck. Housing starts fell 2.2 percent in August, their third monthly decline in a row. While still at historically high levels, it lost more steam than analysts expected. Any sign of a slowdown in housing (one of the economy's leading indicators) during this recession could be cause for concern, although some analysts say there are signs a pickup is possible later in the year. The Federal Reserve Board's periodic survey, known as the Beige Book, concluded that economic growth decelerated in the second half of July and in August. Reports from manufacturing companies suggested that the sector experienced "little to no growth." The residential real estate market continued to boom, but its commercial counterpart remained soft, according to a recently released report. Almost all of the Fed's 12 district banks reported that employers were concerned about the rising cost of health insurance, an important element of labor costs.

The number of uninsured in the U.S. is around 19.7% of the labor force, now up to 41 million individuals. The fear of possible war with Iraq sent stocks tumbling on Monday, sending the Nasdaq down to its lowest level since 1996 and extending the longest bear market stocks have seen in 60 years. The Nasdaq Composite Index declined 36.16 points, or 2.96 percent, to 1,184.93, closing below 1,200 for the first time since September 1996. The Federal Reserve Board's Open Market Committee voted last month to leave interest rates alone. However, two Fed members pushed for a cut, arguing that the economy needs a boost. The Federal Reserve kept its target for short-term interest rates at 1.75% - a four-decade low - and repeated its opinion that risks in the economy are tilted toward slower growth rather than inflation.

The guardians (the G7) of the global economy gathered in Washington this past weekend hoping to make a little bit of history by vanquishing ugly debt defaults in countries like Argentina and Russia. An IMF proposal followed.

But as nice as it sounded, it was summarily rejected by the very people the plan aimed to help. The world's richest nations and the International Monetary Fund threw their weight behind an innovative plan that would be one of the most significant changes to bond markets in years. Their hope was that developing countries falling into debt default would not fall so deep or so hard into recession if they defaulted on their obligations. But emerging market countries Brazil and Mexico rejected the idea out of hand. The Group of Seven said all emerging market bonds should now include so-called collective action clauses detailing what should be done if a default occurs. The idea has been around for years but only gathered support in recent months after the economic collapse and subsequent default of Argentina. For years Wall Street opposed such clauses in bond contracts. But this year it fell in behind the proposal after Argentina, the former Wall Street darling and erstwhile poster child of IMF reforms, went down in flames.

ARGENTINA

Argentina is a shocking example of why resolving debt crises in a more orderly fashion might be helpful. Since its default in January, Argentina has failed to restructure its debts or do a deal with the IMF to restart aid. The crisis there is so deep, the Argentine economy is contracting twice as fast as the U.S. Great Depression of the 1930s.

BRAZIL

With fears that a $250 billion debt default by Brazil is possible if a left-wing government wins the October elections, there seemed finally to be agreement that something must be done to avoid a repeat of the Argentine debacle.

The IMF, announced it would come up with "concrete proposals" by next April on a second aspect of the plan -- how to set up a sort of international bankruptcy court to adjudicate any problems that might arise. But the worst was still to come. The history of IMF in the last 20 years or so has been one of failure. Together with the World Bank they established the practice of “looting” third world countries. First by working with corrupt governments and second by imposing deals that any successful private company would reject. The so called financial aid to emerging markets in the past were part of selling of government utilities at discounted prices to foreigners in order to repay the debts. Another system has been the “stabilization” of commodities prices against a free trade (import) of finished goods and technologies with high value added and increases in prices.

The entire new episode is reminiscent of efforts by the IMF in recent years to set up a “new loan facility.” The lender set up a contingency loan facility that would be available to guard countries with good policies against possible crisis. For more than a year, the IMF publicly courted Mexico to sign up for the loan. Mexico, wary of how Wall Street would think about this deal, shied away and never signed the pact. Thanks heaven taking Mexico's lead, that no other country signed up for the new facility. Last week, three years after the loan facility was announced with great fanfare, the IMF quietly said it would reassess what to do with it. I hope it will vanish forever. Moreover, after stinging criticism of the two world organizations by Nobel Prize winner and former World Bank chief economist Joseph Stiglitz, a new book from a Cambridge University professor challenges the very essence of these institutions -- that forced globalization and free trade are a sure-fire path to prosperity.

The recent meeting of the Group of Seven in Washington made the usual, bland reference to currencies: “We will continue to monitor exchange markets closely and cooperate as appropriate.” Currency markets have mostly priced recent signs of sluggish growth from the United States, Europe, and Japan. The litany is the same over and over. Currency analysts said the Euro central bankers also gave markets little direction on the European single currency. They are wrapped in cast iron and red tape bureaucracy. Germany has about 10% unemployment and other EU countries are around that figure. There is no one in Europe that shows leadership and courage in cutting red tape and taxes and freeing the energy of the market. In many of my previous newsletters I predicted what we now know to be the results of the Euro-Byzantine administration.

JAPAN

Signs that the world's second-largest economy may be ready to take long-overdue steps to dispose of a mountain of bad loans weighing down Japanese banks. But there was little news to be gleaned from Japanese officials over the weekend. Pressure on Koizumi has grown after the Bank of Japan's shocking decision to buy shares from commercial banks to help improve their balance sheets -- a controversial attempt to prevent a financial crisis. Indeed, Japan's gaffe-prone finance minister only muddied the waters further. The country is in cultural and bureaucratic stagnation. The day that the government wakes up to the 21st Century it will the day the Japanese economy will begin to grow again.

THE SYSTEM

The International Monetary System that came out after the World War II is in dire need of reform. It is now time that investors realize that the world financial and economic system has being manipulated. There is evidence that it is increasing difficult for small and micro companies to succeed. Mountains of debt are sinking the telecommunications industry. The currency system has being manipulated by governments for long time, along with the so called “money centers.” Taxation and government spending in developed countries has being increased year by year since the beginning of the 1900. Oil prices are fixed by a cartel. The U.S. dollar is on steroids. The continued manipulation and short selling of gold could cause a major currency disaster. If gold goes above $345 and remains above that level, the U.S. dollar will tumble between 10% and 20% within few months. Many nations are borrowing gold from the U.S. Treasury and shorting it on the market. The European for their part are living the high life and increasing of the welfare state without an increase in production. Retirees in the EU will break any government coffers.

The Stock Market

Following is the latest news. Merrill Lynch and J.P. Morgan Chase & Co., two of the world top investment banks, faced with diminished merger and underwriting work, are preparing to cut thousands of more jobs. As Wall Street's losses deepen, the cuts would be the latest for the global investment banking sector, which is already estimated to have shed some 60,000 jobs since the start of 2001. The boom and bust economy keeps running. The DIJ closed today at 7422, and is down about 25% since January 2002. The NASDAQ, at around 1119, is down about 45% since January 2002. The European stock markets are down between 40% to 50%. The Neuer Markt (a kind of NASADQ of Germany) has been closed. The level of negativity has reached the maximum level with investors. Two scenarios are possible: 1) the market will recover slowly but steadily; 2) the NASADQ index will go to 900 or lower, and the Dow to 6500. In the first scenario, it means that the real economy will start to pick up in the first quarter of 2003. In the second scenario, the economy will not be moving until 2004 at the earliest. Major uncertainty is factored in the market due to the discussion of war with IRAQ. As written in my past newsletters, the real estate market is keeping the economy from further deepening into the recession.

What to Do

My previous forecast of February 2002, was accurate. I now believe that if the U.S. does not go to war with IRAQ, the economy will pick up during the first quarter of 2003. It will be a slow recovery for the first two to three quarters of 2003. If war erupts, we shall revisit the forecast. Interest rates will stay the same until Spring 2003. Stay liquid up to 50% of your asset. Increase opportunities are emerging in the stock market. A lot of research is required at this time before you invest. I suggest to work with a smart independent advisor.

Asset Allocation

In this sector, I suggest maintaining about 65% in US dollars and the remaining in Euro, British Pounds, and Swiss Franc. You may also diversify in currency by investing between 5% to 7% of assets in gold or gold stocks.

Life Sciences Sector

Being a sector of innovation, I believe that a large portion of your portfolio should be invested in this sector. Moreover, you should use hedging strategies to defend your portfolio from the extreme volatility of the market.

Our preferred list

ASTM, AVE, BRL, CEGE, CYTC, DNA, DVSA, CEPH, CHIR, GSK, ITMN, IVX, KG, MEDI, NicOX (Nuveau Marche' France), MLNM, MYGN, NBIX, PPDI, PTI.TO, RGEN, SCLN, SRA, and WPI.

Indexes: DJI 7.422.84 - NASDAQ 1,119.40 - S&P500 785.28- Russell2000 338.29 Amex BTK 309.56

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