Investor's HOTLINE

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Exclusive sound-wealth wisdom from the world's leading financial experts

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March 2004

Forenotes from JOE BRADLEY

March Guests

1. **Paul van Eeden**, an analyst and editor who focuses on gold, clarifies the precious metal's role as the currency of last resort.

2. **Charles M. Ober**, manager of the T. Rowe Price New Era Fund, shares his insights on the natural resource sectors.

3. **Charles O. Butler, Jr.**, presents the basics about EverBank's foreign currency accounts.

4. Interviews were released on 2/20/04 and completed the week prior.

Insights from Guests and Members

1. Many IH guests concur with the Wall Street consensus that the US$ is in a long-term downward trend.

2. Our guests see the declining dollar as an indicator of future inflation in commodities and natural resources—particularly precious and base metals; many say that gold is beginning to respond as a monetary metal.

3. An IH member in the steel business says that virtually all suppliers in that industry have been experiencing 15 percent increases across the board; an IH hedge fund informant tells us that Harvard University has a 20% position in lumber.

4. Australian members note that some IH guests have failed to point out that gold has risen only modestly against the Aust$ and other foreign currencies; Joe mentions that the S&P 500 has traded up from its Oct. 2002 low as much as 46% in the US$ but only 21.7% in euro terms.

5. Our Aussies also raise concern about business practices in China and Asia in general, where corruption is high, the legal system is weak, and patent laws are non-existent; if Enron can run amok in the US, what might happen in less regulated countries?

6. They suggest that if China and India are going to be the economic powerhouses of the 21st century, Australia and New Zealand (who will supply them with commodities) are the "Asian play" with safety and transparency.

For membership information visit: www.investorshotline.com

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The Global Outlook

1. Looking out five years, the global outlook is not very bullish; the US economy is likely to continue weakening, which will drag down most of the rest of the world's economies.

2. The US$ may rebound short-term but its long-term trend is down—some unpredictable volatility should be factored into an investment plan; gold and other currencies should go up, but gold will rise even more versus the US$.

Forecast for the Dollar

1. Van Eeden is not concerned that the Wall Street consensus on the dollar decline will trigger a contrarian move up; all the factors that caused him to take a then-contrarian bearish view in 1998 are still in place.

2. The negative fundamentals for the dollar are so blatant that the Fed will have a hard time doing anything about them.

3. Enough people now use technical analysis that it becomes a self-fulfilling prophecy, so a significant rebound for the dollar as it approaches previous lows on the US Dollar Index is possible.

4. Van Eeden prefers to use his broader, proprietary index of 36 currencies that are GDP-weighted; on that index, the US$ is nowhere near the lows of 1995–96 or 1992; there is probably another 40% decline to go.

The 1990s as Prelude

1. In the 1990s the US economy grew rapidly without measurable signs of inflation; enhanced productivity was the bogus explanation.

2. In actuality, the US benefited from the flight of capital from a series of countries around the world undergoing currency crises—e.g., Brazil, Mexico, Japan, Southeast Asia, Russia, the euro, etc.

3. Capital moving into the US created demand for dollars that impacted the exchange rate of the US$ with every currency in the world.

4. The dollars consumed for capital purchases reduced the dollars available for trade settlement, so the price of dollars got bid up relative to all the countries that trade with the US.

5. Van Eeden's proprietary index shows that the US$ appreciated 112% between 1992 and 2002; the drop since then has only been about 15%; all that capital that came into the US is a liability, so the US$ has a long way down ahead.

Power of the Fed

1. Attributing the rise in global markets since March 2003 to the power and conscious decision of the Fed puts the cart before the horse; markets went higher by themselves in reflection of the US$ exchange rate.

2. Now the US trade deficit and balance of payments deficits are an enormous pressure for the dollar to go down.

3. The Fed was a by-stander in 1996 that issued warnings about the irrational stock market but could do nothing to stop it; its strong-dollar policy followed

the de facto development of a strong dollar, and its policy reversal followed the beginning of the dollar weakening.

4. The Fed has no real control over the growth of money and markets via interest rates; although the Fed sets the overnight rates, longer-term rates have the real impact.

5. The only way the Fed can influence long-term rates is to be in the market buying bonds, but the government needs to be borrowing to cover enormous deficits.

6. Although repeated reduction of the discount rate helped pull long rates down, eventually, credit quality deteriorates to the point of being a problem for banks—then banks will not loan money out to those who cannot repay; the amount of outstanding debt in the US is staggering.

Health of the Markets

1. The stock market is in worse shape than in the late 1990s; the P/E ratio of the S&P 500 is as bad now, but the market has lost its upward momentum; 2003 was a bear market rally; the stock market is very risky at such high valuations.

2. The real estate market is at risk to deflate or even crash; people refinanced their homes to take cash out instead of reducing monthly payments; as Fannie Mae and Freddie Mac come under scrutiny, credit to them will tighten with a domino effect.

3. A decline in real estate prices has a far more severe effect on the economy than a decline in stock prices; in the very long term, real estate will be okay.

Investment Posture

1. The safest place for money now appears to be in investments that run counter-cyclically to the US$; for example, the stock of companies that have an expansion of margins because they export.

2. Van Eeden's preference is to invest in gold; he foresees gold reaching a sustainable $1,000/oz in the next five years.

3. Gold does not act like a commodity and is not used as a commodity, but the assertion that central banks control its price is false—plotting the gold price since 1990 against central bank sales of gold shows no correlation.

4. None of the other commodity-driven assumptions matter either, e.g., producer hedging and net investment demand.

5. Most of the gold ever mined is still above ground (145,000 tons); what impacts its price is the relative inflation rate of the aboveground stockpile vs. that of the currencies used to measure its value.

6. Central bankers were behaving like momentum traders when they sold gold (decreasing in value) for dollars (increasing in value with interest income); expect them to reverse course as gold continues to rise against the US$.

Playing Gold

1. The gold stock market is very small with very few stocks desirable to own because they are presently expensive; van Eeden prefers selecting five individual stocks to buying a mutual fund.

2. If you do buy gold stocks, focus on big, high-quality companies such as Newmont (NEM), Goldcorp (GG) or possibly Placer Dome (PDG); avoid Barrick (ABX) because of its hedge book problem.

3. The safest hedge against a decline in the US$ is physical gold; if gold is going to $1,000/oz. in the foreseeable future, its price today is irrelevant; expect to double your money on physical gold in the next five years.

4. If you don't like not earning interest on a gold investment, buying a basket of currencies is an alternative play against the US$, but select carefully.

5. The gold stocks should retain their high premium, and people will grossly overpay for no good reason; management, political and social risk are all part of buying a stock—decide if the additional risks are worth the possible leveraged reward.

6. Van Eeden's favorite junior gold stock is Altius Minerals (ALS.V—on the

Special Briefing. . .

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The Foreign Currency Option

1. EverBank offers people liquidity in a foreign currency using a US bank; individuals may use a money market account or a CD (maturity of 3 or 12 months); FDIC insurance covers the deposit for failure of the bank but not currency risk.

2. EverBank opens the account, converts the currency and funds the money market balance or CD in euros or another foreign currency offered; statements and confirmations are shown in the foreign currency.

Setting Up an Account

1. An application can be sent to you by mail or email attachment or downloaded from the web site; EverBank is working toward complete Internet capability for applying.

2. A customer completes and signs the application (showing kind of account and currency choices) and returns it to EverBank with a check to fund the account.

3. If the customer wishes to wire funds, the application can be submitted first (by fax) to obtain an account number.

Account Comparison

1. The money market account offers liquidity but almost no interest (less than 0.25% under $50,000 or 0.5% over $50,000).

2. The CD locks you in for the term but offers the interest rate available in the country of your currency choice; e.g., a 3-month euro CD pays 1.25%.

3. Either choice has the potential for gain (or loss) of the foreign currency against the US$.

Fees

1. An investor can roll the CD over indefinitely for no charge simply by giving EverBank instructions.

2. EverBank charges a fee for currency conversion of 0.75% for amounts up to $100,000 and 0.5% for larger amounts (compared to typical conversion fees of 2.5%–5.0%); the charge is factored into the price of the currency.

3. EverBank goes into the market every day with bundled trades in order to get as close to the spot transaction of large institutions as possible; the customer's price is based on what EverBank pays for execution; bid and ask spreads for currencies are negligible.

Canadian Venture Exchange); ALS's superior management makes it the best-run junior mining company in the world, plus it has a lucrative nickel royalty.

Buying Physical Gold

1. The simplest way is to buy coins, but for large quantities the best way is to buy ETFs (exchange-traded funds).

2. Van Eeden recommends one traded in Australia and one traded in London; you'll get the benefit from the declining US$ regardless of where the ETF trades.

More Illuminating Points

1. There is no global bull market in gold but rather a bear market in the US$; what American investors need to do is protect their buying power.

2. What's important for mining companies is where the mine operations are, not where the stock trades; Americans are better off investing in physical gold than South African shares.

3. On the basis of risk/reward, investment opportunities look better in the high-risk exploration sector for all the metals because mining companies need new projects.

4. Early exploration is controlled by the junior sector, which offers leverage from multiple sources—the correct currency, a general rise in commodities and a dire need for the specific product.

5. The gold sector is dangerous now in spite of an eventual $1,000/oz price—unless you know the intrinsic value of the mining stocks you buy, stick to physical gold.

6. Money can be made in trading gold stocks; they will go up because investors are ignoring the fundamentals, and they will come down when people recognize the fundamentals—that is the risk.

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The Global Outlook

1. Emerging markets will continue to grow, especially with recoveries in Latin America; the OECD [Organization for Economic Co-operation and Development] is starting to recover, generating incremental demand for resources.

2. The money from the numerous Fed rate reductions has gone into the pockets of US consumers, keeping the retail sales sector stronger than expected in a downturn; the equity from appreciated home values has also provided fuel for the economy.

3. The global boom in commodities has resulted in part from Fed actions but also from concerns of the EU and other individual countries about the weakening US$—they have played a game of low interest rates and competitive devaluations to protect their own capital.

Deflation/Inflation Risk

1. The primary reason for concern is how globalization has kept costs under control; the US transfer of jobs and production overseas has resulted in lower costs being imported back into the US; the overall price level of goods and services has hardly risen, and corporate America has not had pricing power.

2. The globalization phenomenon continues, but the economic recovery and resulting job creation will offset the deflation; the inflationary forces from labor cost will become more significant.

3. As workers become more certain of their positions, they will be more assertive about wages; workers' budgets have suffered from higher energy, healthcare and incipient food costs.

Quality of the Recovery

1. The improvement in business confidence is an encouraging sign that the recovery may be sustainable—business spending is starting to pick up; managements had been cautious as a result of the Middle East situation, corporate scandals and excess capacity (especially in telecommunications and technology).

2. Whereas the consumer had been shouldering the recovery alone, now business capital spending is bearing some of the weight.

Commodity Analysis

1. Commodities are less of an inflationary influence on the consumer than they have been in the past; now there is more room to grow.

2. Inflation in the 1970s was levered to energy prices; besides precious metals, other commodities did not take off because so many dollars for consumption were used for higher energy costs.

3. The fact that the oil shock going into 1980 occurred in the context of a stronger economy really caused inflation to spurt; a weaker economy now has been able to absorb energy price increases and probably will be able to absorb increases in other commodities, too.

4. The ratio of the consumer price index divided by the producer price index has steadily declined since 1918—it's lower now than in the 1970s.

5. Commodity prices over the next year or two may not go a lot higher, but their high levels should be sustained; a collision of supply and demand is taking place—e.g., no additional supply of natural gas is being added, and certain demand segments are being destroyed as a result.

Outlook for Oil

1. In the case of oil, major oil companies are unable to replace production at past cost levels; there is very limited growth in non-OPEC supply.

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2. A higher sustainable price is required to get a reasonable rate of return to invest—the old range in the oil price of $18-$22/barrel is moving toward $25–$30/barrel.

3. China has become a major demand factor in the oil market, surpassing consumption in Japan on a gross basis; China represents the biggest incremental portion of growth in demand for 2004.

Other Strong Commodity Sectors

1. The metals are very strong; China is a growing consumer of metals for infrastructure, housing and products for export—the country consumes about 22% of all the metals together, and its share is rising; possible short-term shortages of copper are attributable to Chinese use.

2. Grain inventories are declining annually—also due to Chinese consumption; currently, China is particularly buying soybeans on the world markets.

3. The New Era Fund has not replaced its grain stocks over the last five years; instead, the fund invests in agriculture through fertilizer companies.

Precious Metals

1. Gold and silver should be higher over the next 12–24 months; gold has been strong primarily because the US has been debasing its currency; fundamentally, jewelry demand has been strong.

2. Gold producers are no longer hedging forward and keeping a lid on the price; gold has become more valuable as a reserve.

3. The political difficulties in the Middle East impacted the rally, but the US$ decline will be the biggest reason for sustained strength in gold.

4. Central banks that had been heavily selling gold in the late 1990s and early years of this decade are no longer selling—they are rethinking whether to hold reserves in US$ or gold (or euros).

5. Even OPEC is considering pricing oil on a basket of currencies or the euro instead of the US$.

6. Inflation will become more of a factor driving the price of gold.

Plays on OECD Recovery

1. New Era Fund is investing in two later stage commodities that are more dependent on recovery in the OECD than on China (although it is a factor).

2. One of the areas is forest products and paper—paper demand picks up as business activity and advertising pick up; demand from China is not as strong in this area because paper is not necessary for the infrastructure or transformation to an industrial power.

3. Chemicals are also an area stimulated by a global upswing; excess capacity persisted globally while the US experienced cost inflation due to the relationship of the petrochemical industry to natural gas.

4. Steel plays held by New Era include Nucor (NUE) and International Steel Group (ISG); expect the strong recovery in the steel market to continue on the heels of demand from China.

5. NUE's margins have suffered a bit because the company competes with China for scrap, but the raw materials for the integrated steel producers have been rising even more rapidly lately.

6. China is an interrupting factor in the steel markets when it periodically brings on additional capacity with new steel plants; however, the country is not self-sufficient with aluminum or the basic components of steel, iron ore and coking coal.

7. Iron ore, coking coal and aluminum are attractive, long-term investments because demand should be steady.

New Era Strategy

1. The New Era Fund (PRNEX) diversifies into natural resources beyond energy to achieve lower volatility over time even though the strategy moderates returns during booming energy periods.

2. The fund also looks for opportunities downstream from commodities as a way to offset commodity declines; e.g., oil refineries may do better than oil during periods of declining oil prices.

3. Other diversification areas include steel, paper and chemicals (the latter two of which have lagged the recovery in metals and energy).

4. The ratio of energy to industrial materials has come down from about 56% to 50% through appreciation of the metal segment and increased investment into that area.

5. To cope with some metals stocks getting ahead of themselves, New Era has shifted some money from some pure producers such as Inco and Cleveland-Cliffs to multi-line producers such as BHP, Rio Tinto (RTP) and Companhia Vale Do Rio Doce (RIO).

6. The managements of these multi-line companies are more disciplined and more financially oriented in handling their cash flow.

7. Ober expects the fund to mute much of the downside action if the general market corrects strongly because of the fund's emphasis on value-oriented, hard asset companies that can do well in periods of rising inflation.

Recent Attractive Opportunities

1. Ober has put some incremental money in correcting oils such as Murphy (MUR), Total (TOT), BG Group (BRG) and Royal Dutch (RD).

2. He has shown incremental interest in steel companies and chemicals that appear to have further to go in the cycle; besides NUE, Steel Dynamics (STLD) looks good longer term as well as Millennium Chemicals (MCH).

3. Recent additions in precious metals include Meridian Gold (MDG); Impala (IMPUY.PK) is a play in platinum.

Closing Thoughts for Investors

1. The traditional pattern for cyclical industries is movement from a weak economic trough to a pick-up in economic activity that generates brief, tremendous cash flow.

2. That cash flow gets reinvested in new mines and facilities; these become excess capacity with the next economic downturn.

3. Managements are now more financially responsible and tend to follow the ultimate Exxon model of allocating capital among production, repurchase of shares and acquisitions.

4. This change coupled with a long period of little exploration means that there is not much new capacity in the pipeline now; future capacity decisions will be slow and rational, based on experience with cycles.

5. As we exit this cycle, if global economies turn down, prices are likely to remain higher; the evidence from domestic natural gas markets and global oil markets supports this view.

6. The cycle top is probably still 2–3 years out globally as recoveries occur in Japan, Russia, Argentina, Brazil and Mexico along with a gradual OECD recovery.

IH members are cordially invited to **FreedomFest 2004**
a conference produced by Mark Skousen
May 13–15 in Las Vegas
For info, call 800-USA-1776 or visit www.freedomfest.com
Early bird deadline is March 15!

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