

OUTSIDE THE BELT-STREET

JULY 2005

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SPECIAL POINTS OF INTEREST:

- **Mutual Funds—Historic Low Cash Levels**
- **Death of the Dollar?**
- **Worst Employment on Record**
- **The Financial Statement of the USA**
- **The Hall of Shame**

TEENAGE INVESTING

I am very fortunate to have two great teenage sons. Sure, there are times when we have a good argument or two, but overall they're really great guys. One aspect of their growing up that is *somewhat* comical, is their attitude toward money. I hear things like, "Dad, I know I lost the _____, but can't we just get another one?" or, "What do you mean that I need to pay for my gas?" I must admit my relief when I occasionally hear, "You wouldn't believe how much I had to pay for _____."

If your children are old enough for you to have journeyed through those years, then I am sure you have plenty of memories of these transitional times. No matter how much we tell them, "Listen, you don't understand," they always look back at us, with some frustration, thinking they do understand. Still, we know they don't. They can't even begin to fathom all that they do not know. Though we never like to see them go through pain, we sigh and realize the experiences of life will bring home these lessons.

The reality is that most investor's and advisor's (myself included) only experience with a bear market is the period from 2000 to 2002. We have no memory of the struggles that occurred in the 70's, when inflation ripped through the bond market. We have no life stories of what it was like to experience the Dow Jones Industrials getting crushed in three, deep bear markets over eight years, declining from 991 in 1966 to 596 in 1974.

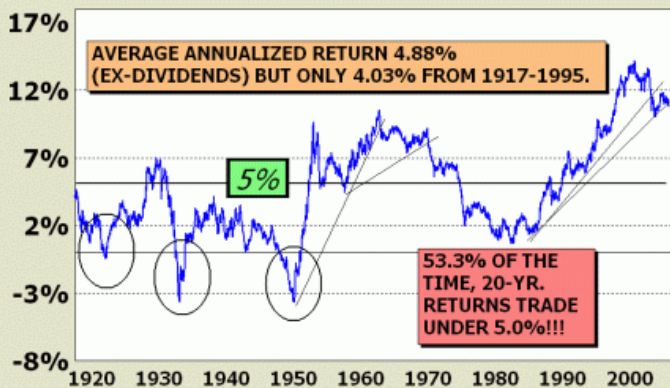
Sadly enough, our ignorance is not because of a lack of information. Rather, it is because, with thousands investing and advising in the same way, with no long-term bear experience, it is just easier to buy into the simple ideas, put the 2000 to 2002 period behind us, thank God for the Feds cutting rates and allowing a historical flood of credit, and follow the masses into a comfortable future. After all, most of our friends are doing the same. It must be right.

This issue will focus on a variety of pictures, making it clear that some investors and advisors have been willing to ask tough questions. And, just like high school, when common sense says that the investing crowd is wrong, we must have the fortitude to stand our ground.

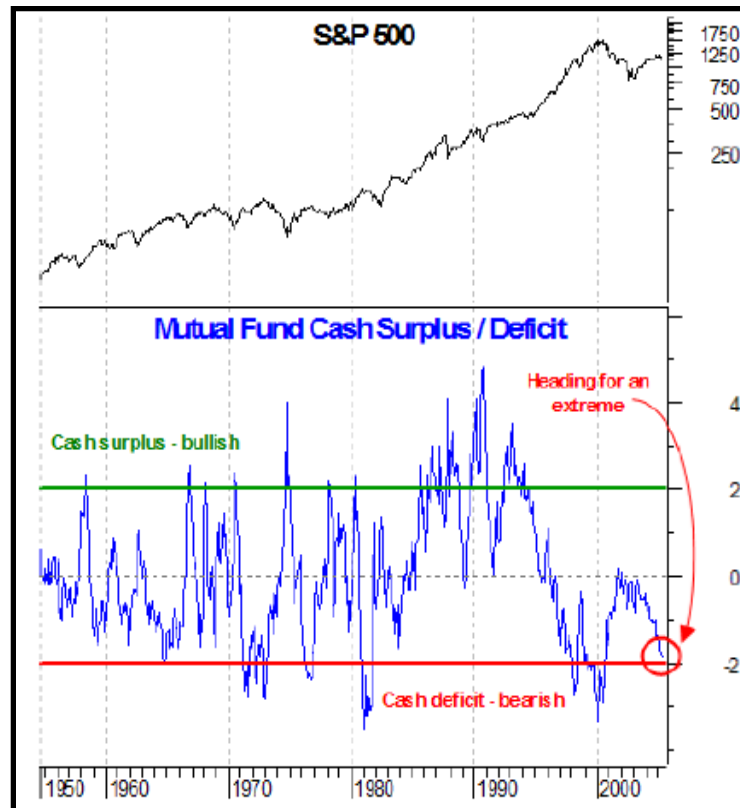
If a picture is worth a thousand words, then we all can learn a lot from the following "lectures."

PICTURES FROM THE GALLERY-MARKET WARNINGS

Annualized Returns For DJIA Over All 20 Year Periods 1917-2005



The chart below was developed by Jason Goepfert, at www.sentimentrader.com.

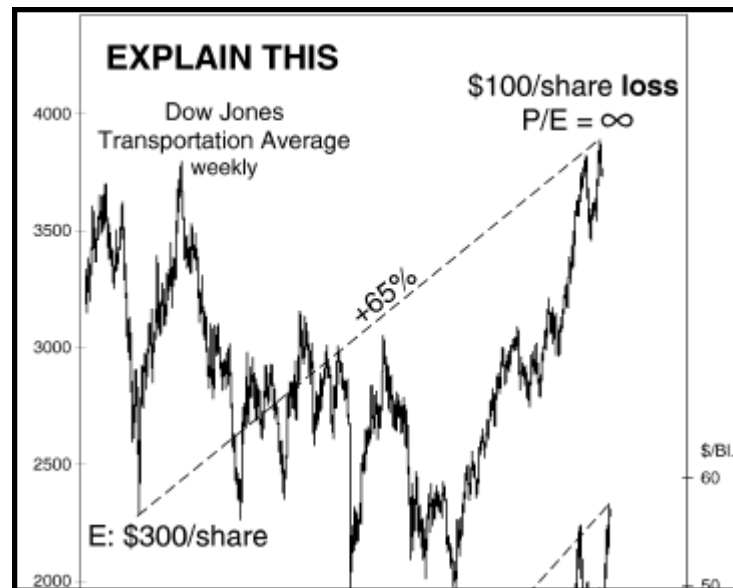


Dow Jones Industrials Support & Resistance

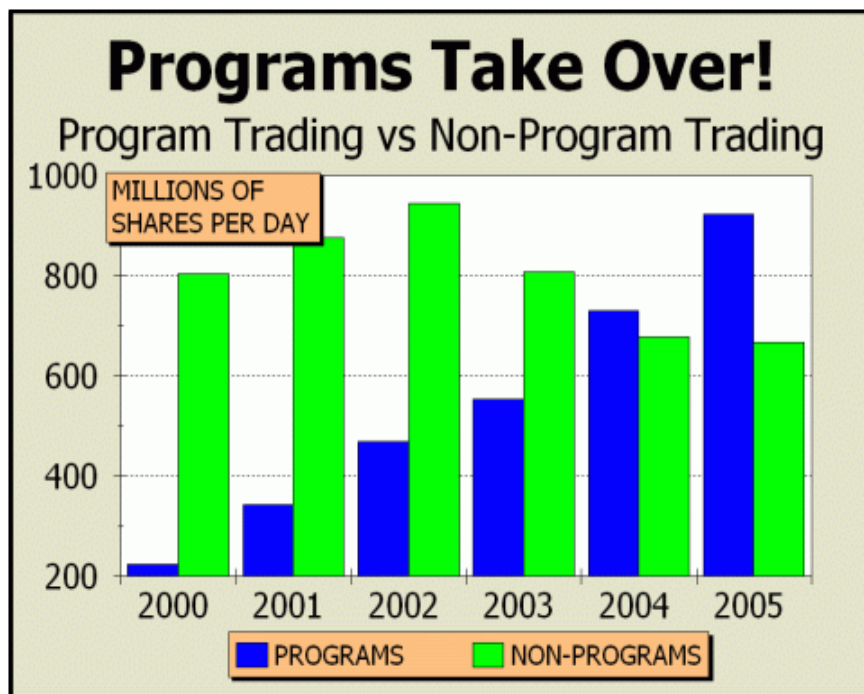
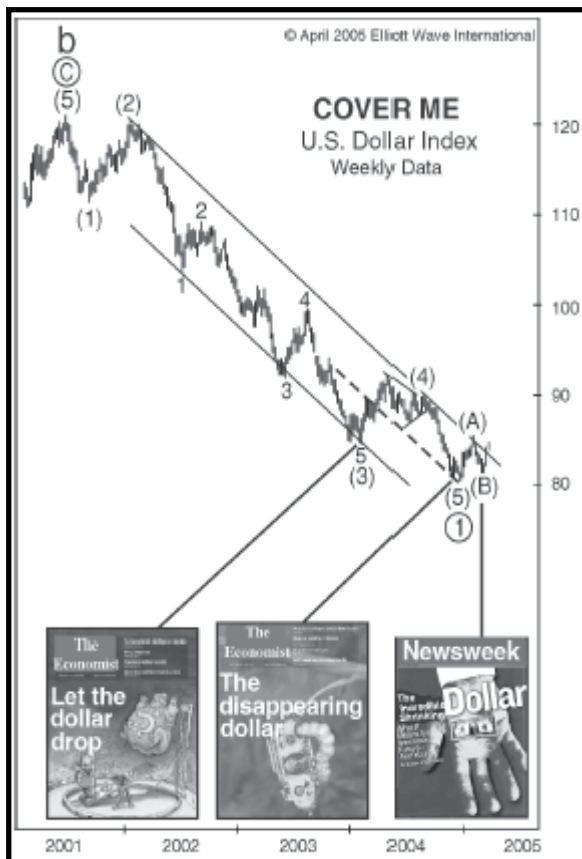


The upper left charts were created by Alan Newman, at www.cross-currents.net.

The bottom right chart is compliments of www.elliottwave.com. I left off the bottom part of the chart in order to focus on the DJTA. This chart is from 1998 until 2005. The total earnings from the companies that comprise the DJTA declined from a \$300 a share to a loss of \$100 a share. During this period while the price increased 65%. What???



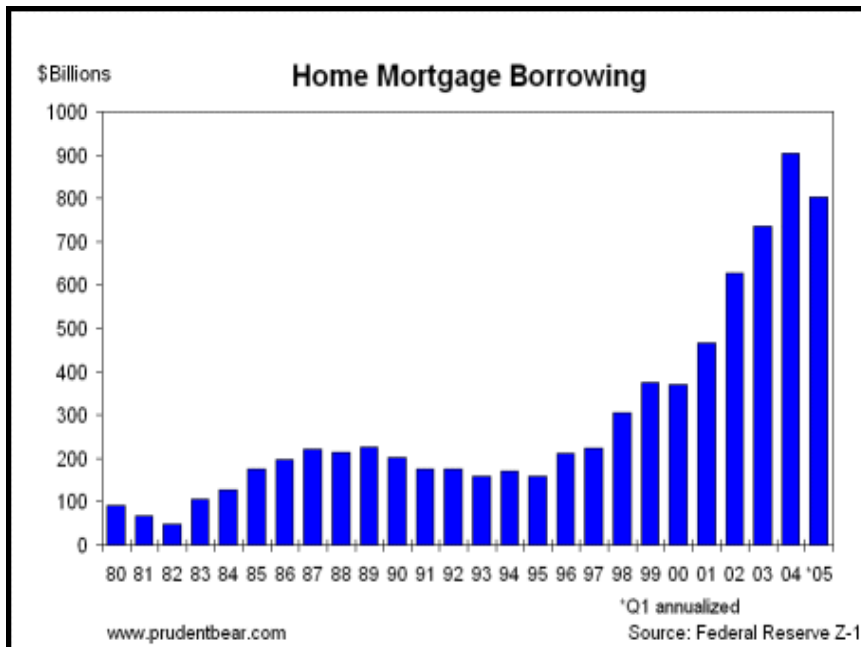
PICTURES FROM THE GALLERY- MARKET WARNINGS



The two charts at the top were created by www.elliottwave.com. The magazine cover indicator was established by Paul Macrae Montgomery, www.montgomerycap.com, as a contrarian signal of the end of a trend.

The chart to the left illustrates the rising force of computers making program trades. It was developed by Alan Newman at www.cross-currents.net.

PICTURES FROM THE GALLERY- CONSUMER WARNINGS



Save On Your Mortgage By Refinancing
Advertisement

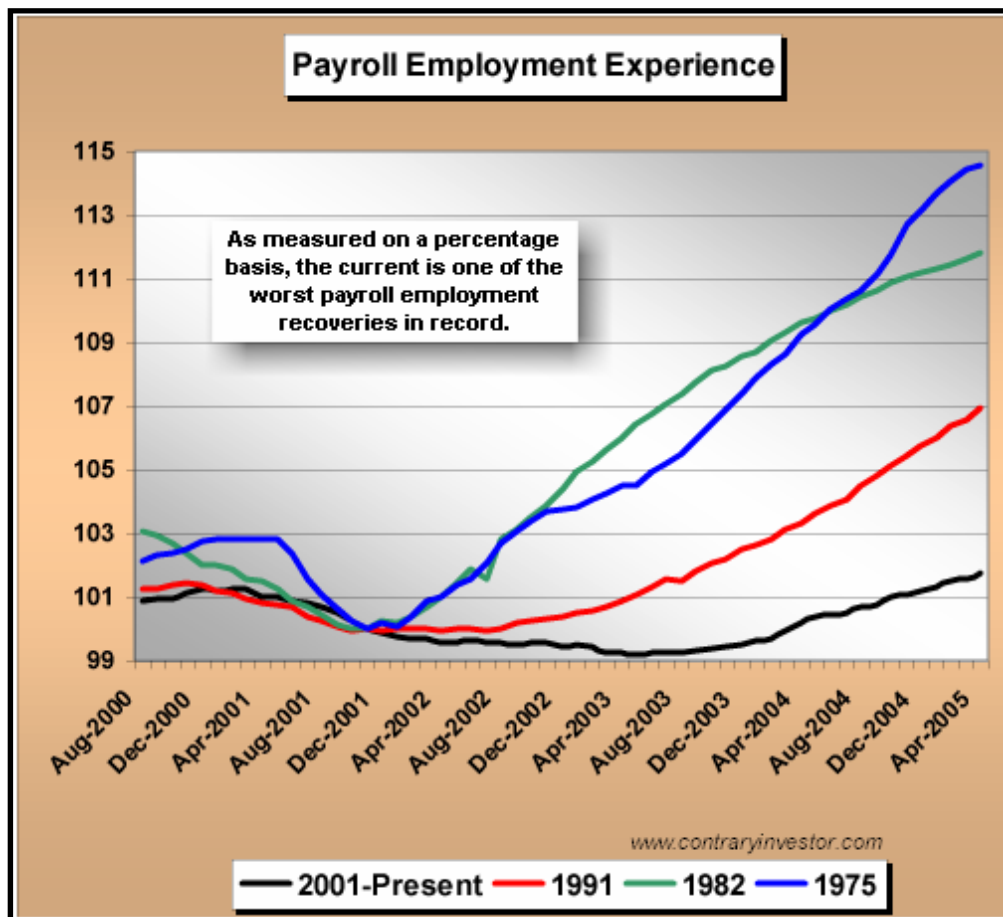
- Cash Out!
- Lower Your Interest Rate!
- Free Quotes, Less Paperwork, Easy and Fast!

Let Your House Pay Your Bills!

Refinance, Save big on interest and have tons of cash for all your needs!

[Click here](#)

Remove Service located at website



The picture to the upper right is an advertisement that was sent to our office.

The chart to the upper left, showing home mortgage borrowing, is from www.prudentbear.com

The chart to the left, showing payroll employment during economic recoveries, is from www.contraryinvestor.com.

PICTURES FROM THE GALLERY-GOVERNMENT WARNINGS

Overall Perspective
(in billions of dollars)

ASSETS

	2004			2003			\$ Change
	Balance Sheet	Additional Responsibilities	Combined Amounts	Balance Sheet	Additional Responsibilities	Combined Amounts	
Inventory, cash	\$ 359	\$ -	\$ 359	\$ 372	\$ -	\$ 372	\$ (14)
Property, plant & equipment	653	-	653	658	-	658	(6)
Loans receivable	221	-	221	221	-	221	(0)
Other	165	-	165	154	-	154	11
Total Assets	\$ 1,397	\$ -	\$ 1,397	\$ 1,405	\$ -	\$ 1,405	\$ (8)

LIABILITIES & NET RESPONSIBILITIES

Social Insurance							
Medicare (Parts A, B, & D) ¹	-	(24,615)	(24,615)	-	(15,008)	(15,008)	(9,609)
Social Security (OASDI)	-	(12,552)	(12,552)	-	(11,742)	(11,742)	(810)
Other (Railroad Retirement)	-	(112)	(112)	-	(110)	(110)	(2)
Subtotal, Social Insurance	-	(37,279)	(37,279)	-	(26,858)	(26,858)	(10,421)
Fed. empl. & veterans pensions/benefits	(4,062)	-	(4,062)	(3,880)	-	(3,880)	(182)
Federal debt held by the public	(4,329)	-	(4,329)	(3,945)	-	(3,945)	(385)
Other liabilities	(716)	-	(716)	(675)	-	(675)	(41)
Other responsibilities	-	(903)	(903)	-	(862)	(862)	(41)
Total Liabilities & Net Responsibilities	\$ (9,107)	\$ (38,182)	\$ (47,289)	\$ (8,500)	\$ (27,720)	\$ (36,220)	\$ (11,070)

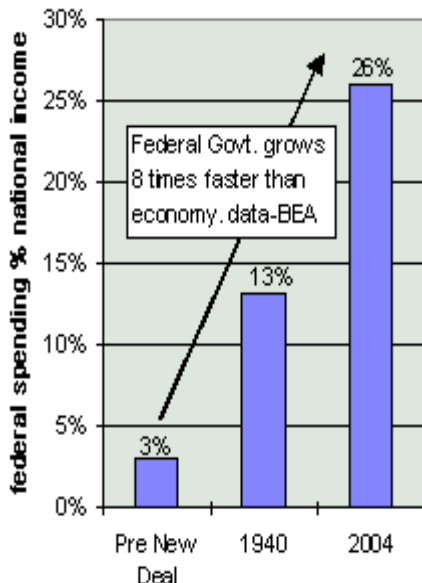
BALANCE (Total Assets minus Total Liabilities & Net Responsibilities)

	(\$7,710)	(\$38,182)	(\$45,892)	(\$7,094)	(\$27,720)	(\$34,814)	(\$11,078)
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¹ Part D's Medicare Prescription Drug & Transitional Assistance Accounts not included in 2003 because both established after fiscal year 2003.

Note: Details may not add to totals due to rounding.

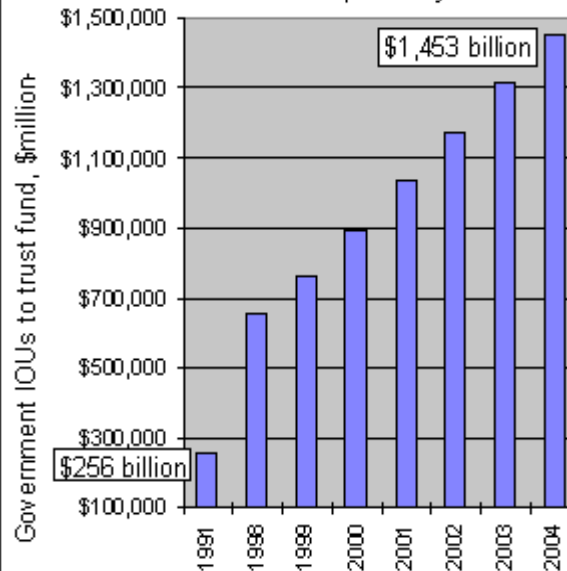
Federal Spending grows 8x faster than economy



Grandfather Federal Spending Report
<http://mwhodges.home.att.net/>

Cumulative Surplus Cash Siphoned from Social Security Trust Fund

- \$1.45 trillion extra in past 13 years -



Grandfather Economic Report
<http://mwhodges.home.att.net/>

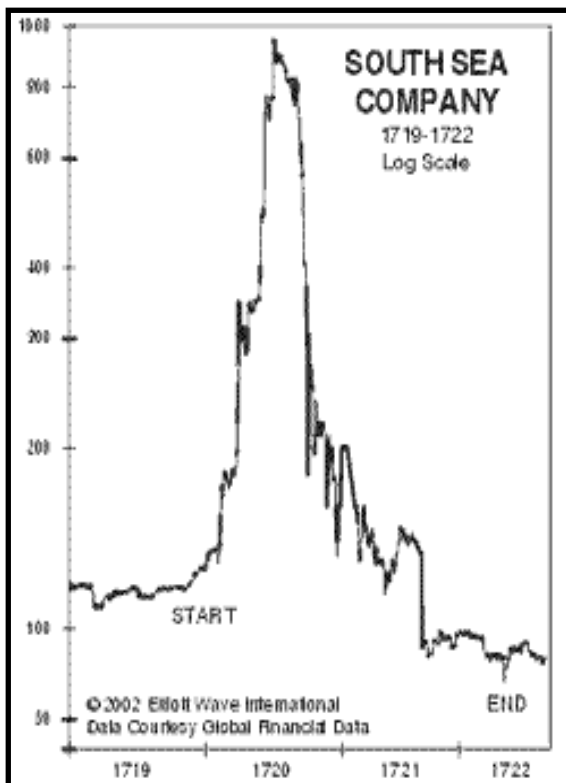
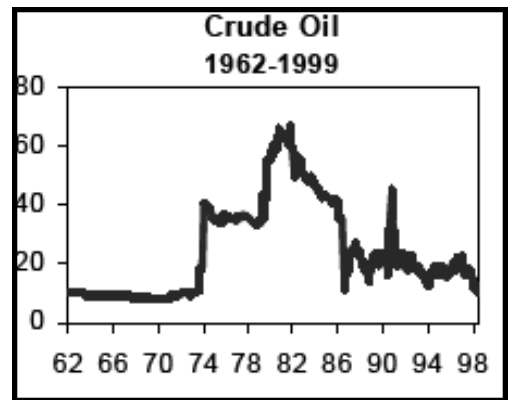
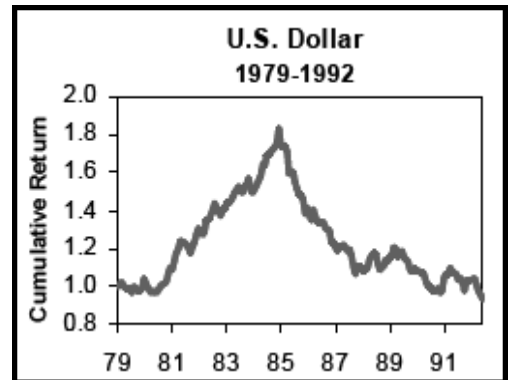
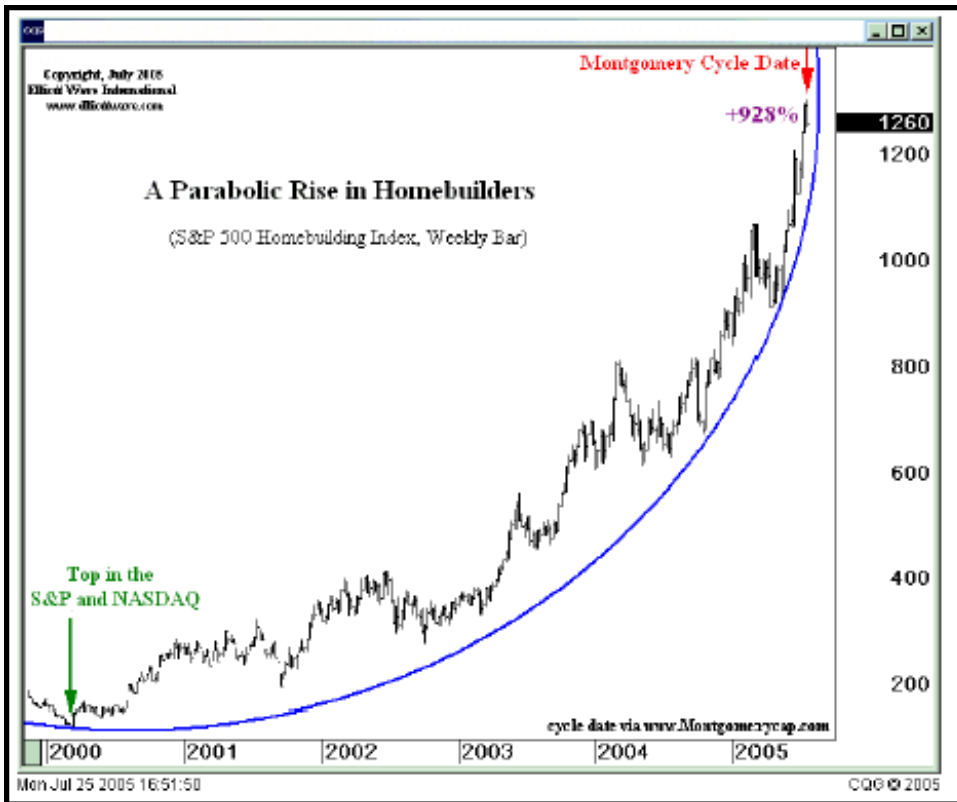
The top chart comes from page 11 of the 2004 Financial Report from the United States Government.

www.fms.treas.gov/fr/

For a comprehensive understanding of the numbers behind Michael Hodges' charts to the left, visit his site at [http://](http://mwhodges.home.att.net/)

mwhodges.home.att.net

PICTURES FROM THE GALLERY- THE DOWNSIDE OF SPIKES



www.condoflip.com

states that, "Bubbles are for Bathtubs."

History disagrees.

Three of these charts are courtesy of Elliot Wave International.

www.elliottwave.com

The smaller charts, to the upper right, can be found in the "The Countdown Continues. 3rd Quarter 2004" by Jeremy Grantham at

www.gmo.com.

PICTURES FROM THE GALLERY- NO FEAR



What a slow game.

We originally prepared these charts (courtesy of www.stockcharts.com) for our December 2004 newsletter. www.bestmindsinc.com

The comparison is simply between the VIX, which is a measure of portfolio "insurance" taken out in fear of a likely downturn in the Dow, and the level of the Dow. Does a pattern exist?

THE HALL OF SHAME

“In conclusion, Mr. Chairman, despite the challenges that I have highlighted and the many I have not, the U.S. economy has remained on a firm footing, and inflation continues to be well contained. Moreover, the prospects are favorable for a continuation of those trends.”

The Federal Reserves Semiannual Monetary Policy Report to the Congress, Alan Greenspan, July 20, 2005. <http://www.federalreserve.gov/boarddocs/hh/2005/july/testimony.htm>

Compare this with the charts on pages 4 and 5 in this newsletter.

“Ben Bernanke, the former Fed governor and new chairman of the Council of Economic Advisors told a Washington group that ‘We are in the midst of a healthy and sustainable economic expansion.’ He’s got that dead right.”

Larry Kudlow, *The Markets Strike Back*, July 12, 2005. <http://www.townhall.com/columnists/larrykudlow/lk20050712.shtml>

Mr. Kudlow even attributes a portion of the “success” of the economy to rising real estate prices and market prices. The chart on page 7 shows that the Dow has been in a trading range from January 2004 until now. On Feb 19, 2005 the Dow hit 10,753. On March 7, 2005 it hit 10,984. Yesterday, July 27, 2005, it hit an intraday high of 10,689. The homebuilders chart on page 6, is clearly unsustainable. If the Dow is being buoyed by homebuilder, what will happen to it when the homebuilders go the way of all bubbles?

Our last induction into the Hall of Shame, is Scott Burns of the Dallas Morning News. On July 27th, a reader asks Burns what he knows about the Rydex funds and the fact that Rydex has funds that “short” certain indexes. He questions, “Would you recommend them in general?” While Mr. Burns gave a clear explanation of how these various inverse funds work, he went on to tell the reader, “It has never been a good idea to bet against America and its stock market, so these funds aren’t taking the world by a storm,” and that “few people are prepared for the stress of negative bets, so most people should ignore these funds.” He then went on to recommend an (long) index fund to the reader.

Mr. Burns suggestion fits well with his “couch potato” investment philosophy as well as what I have termed “teenage investing.” See charts on pages 3, 6, and 7. While it is certainly less stressful to omit the use of short funds and other shorting tools, the historical record is replete with successful stories of short sellers. He also needs to read the second article in our June newsletter, which reveals the amount of short interest on the QQQQ’s as of January 2004 had grown to 52 percent. Evidently, there is a good amount of big money that is not taking Mr. Burns advice. Mr. Burns believes that “these funds not taking the world by storm” is a bad sign for potential investors. John Templeton’s maxim is “Never follow the crowd.”

And, in regards to patriotism and investing in short funds, these are completely separate issues. To put it more poignantly, I ask only one question. Were the leaders of Enron, WorldCom, the S&L Crisis more, or less, patriotic than those who studied these companies and took short positions ahead of their demise?

“Collapsing confidence is generally described as a bursting of a bubble, and event only controvertibly evident in retrospect.”

Alan Greenspan, A Speech in Washington DC sponsored by the Office of Comptroller’s Currency, October 14th, 1999. (emphasis mine)

See all of Greenspan’s speeches at www.federalreserve.gov/boarddocs/speeches/1999/default.htm

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The Mission:

To look to the best minds in the world of finance and economics to seek a direction for our clients and to be a true advocate to those who will listen.

With the “Perfect Financial Storm” brewing in front of us, our actions are more crucial now than ever.

“ THOSE WHO CANNOT REMEMBER THE PAST ARE CONDEMNED TO REPEAT IT. ” GEORGE SANTAYANA , 1905

RISK – LIQUIDITY EQUALS MANIA

How much better our current state of affairs would be if our nation were not ignorant of monetary history. If we only understood the 3 failed attempts at a central bank before the establishment of the Federal Reserve in 1913, our current juncture would be painfully clear. If we understood why fiat currencies lead to “liquidity” and the growth of credit, and thus debt, we would never look to a lender of last resort as a long-term solution for any economy.

The following quotes are from a recent speech by Vice Chairman Roger Ferguson of the Federal Reserve. <http://www.federalreserve.gov/boarddocs/speeches/2005/20050527/default.htm>

“Overly rapid monetary expansion, or excessive liquidity, has been named as a leading suspect in some episodes of unsustainable movements in asset prices. Liquidity is not a precise concept, however. What is meant by ‘excessive’ is even less well defined.”

In February 2000, Jim Grant, of Grant’s Interest Rate Observer, had a piece in the Financial Times where he addressed the term liquidity. “In the run-up to the millennial-liquidity-crisis-that-did-not-happen, the Fed created more than \$100 billion of new credit, thereby stimulating a stock market that hardly seemed to need any additional encouragement”. (**Bull: A History of the Boom**, Maggie Mahar, Pg. 323) Grant’s implication is that monetary liquidity stimulates asset price movements.

Mr. Ferguson goes on to tell us that, “resulting liquidity was greater than would have been ideal was most apparent (unfortunately, more so in retrospect) in Japan’s booming asset prices.” Amazingly, he does not talk about how Japan cut interest rates throughout the 1980’s before their market topped in 1989. Even more amazing, is the largest expansion of credit in history that has occurred in the last 5 years. Yet, Mr. Ferguson and his colleagues cannot define “excessive”. Perhaps, like Alan Greenspan, he could only identify such an anomaly in retrospect.