

Outside The Beltstreet

2004

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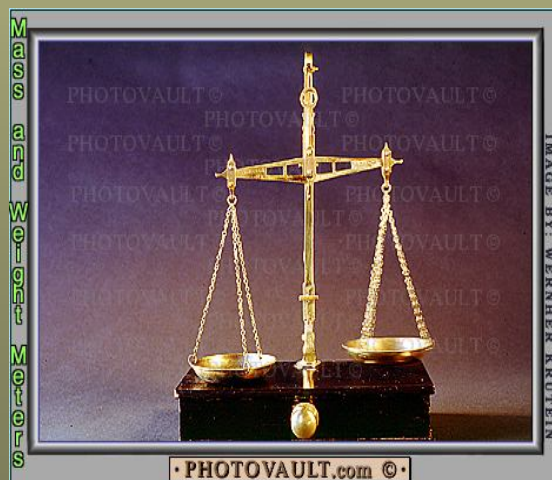
The Case for the Bear Market—Part I

In looking at the money game from many angles over the last 18 months, I have read in excess of 5000 pages. Today I usually cover 700 pages of information a month. Forgetting that most don't read this much, I am sometimes caught off guard by the dogged tenacity with which many still cling to the bull market. In an attempt to clarify my stance, I've decided to write a four part series on 20 reasons why we are still in a bear market. So that I do not seem unfair, I extend an invitation to anyone to come up with 20 reasons for a continuance of a bull market. If I get any takers, and it passes compliance, I will be happy to post both on my website for public comparison.

1. Private Sector Jobs

Private non-farm payrolls are now up only 0.3% over the first 33 months of this expansion. By contrast, at similar junctures of the past six cycles, the increase averaged 7.8%. The gap between the hiring trajectory of this expansion and the composite profile of these earlier recoveries works out to an employment shortfall of 8.2 million workers in the private economy.

(Source - Dr. Stephen Roach, Chief Economist Morgan Stanley, *Spinning Its Wheels*, September 10, 2004)



Bear Case (continued)

2. Foreign Purchases of our Debt

The 2000-2002 period revealed that central banks outside of the US were buying 7.6% of our treasury purchases. The May-June 2004 period revealed a their purchases accounted for 35%. In 1986, their purchases averaged 13%. From January 1987-September 1987 purchases averaged 47.3%. We saw what happened in 1987. What about 2004 or 2005?

(Source - *The Funding of America*, August 23 2004, Dr. Stephen Roach, Chief Economist at Morgan Stanley)

3. US Household Savings Rate

If a country's banking system is healthy, borrowers are suppose to borrow from savers. However, we have been lead to believe, as the Federal Reserve has continued to expand the money supply, through giving ever increasing incentives (in the form of lower interest rates) to borrow money, we don't need to save. However, when US households go from a 10.4% savings rate in April 1980 to a 1.2% savings rate as of June 2004, it is apparent that this trend can not continue indefinitely. Unfortunately, as Americans start saving again, a country that derives 70% of its GDP from consumer spending, will have to slow down. As Americans feel the pressures of inflation, globalization of the jobs market, and of servicing our consumer debts, we will have to slow spending. From numerous signs, that exhaustion point seems to be occurring right now.

(Savings information was taken from Bureau of Economic Analyst July report on Personal Income and Outlays, www.bea.gov and from the article, How Healthy are the Banks, Dr. Frank Shostak, posted March 29,2004 at www.mises.org)

4. CPI and Inflation

The traditional method of calculating the consumer price index (CPI) from 1921 until the early 1990's was a straight arithmetic method, giving equal weighting to all components of the calculation. Then, in the early Clinton years, the CPI calculation was changed to a geometric method so that it gave a higher weighting to things that were falling in price and a lower weighting to things that were rising in price. If the straight arithmetic method was used, the August inflation rate would be 5.4% annually. The quoted CPI-U rate of 2.7% plus the loss from changing back to arithmetic weighting is another 2.7%. For those who are living off of fixed investments and fixed pensions or social security benefits, these differences have **major** implications.

(Source- Gillespie Research, *Government Economic Reports: Things You've Suspected but Were Afraid to Ask!* - The Consumer Price Index, Sept. 22,2004 www.gillespieresearch.com)

Technicals

Overall Perspective (in billions of dollars)	2003			2002		
	Balance Sheet	Additional Responsibilities	Combined Amounts	Balance Sheet	Additional Responsibilities	Combined Amounts
ASSETS						
Inventory, cash	\$ 361	\$ -	\$ 361	\$ 334	\$ -	\$ 334
Property, plant & equipment	658	-	658	325	1 616	941
Loans receivable	221	-	221	219	-	219
Other	154	-	154	119	-	119
Total Assets	\$ 1,394	\$ -	\$ 1,394	\$ 997	\$ 616	\$ 1,613
LIABILITIES & NET RESPONSIBILITIES						
Social Insurance						
Medicare (Parts A & B)	-	(15,006)	(15,006)	-	(12,896)	(12,896)
Social Security (OASDI)	-	(11,742)	(11,742)	-	(11,215)	(11,215)
Other (Railroad Retirement)	-	(110)	(110)	-	(38)	(38)
Subtotal, Social Insurance	-	(26,858)	(26,858)	-	(24,149)	(24,149)
Fed. empl. & veterans pensions/benefits	(3,880)	-	(3,880)	(3,589)	-	(3,589)
Federal debt held by the public	(3,945)	-	(3,945)	(3,573)	-	(3,573)
Other liabilities	(674)	-	(674)	(654)	-	(654)
Other responsibilities	-	(862)	(862)	-	(771)	(771)
Total Liabilities & Net Responsibilities	\$ (8,499)	\$ (27,720)	\$ (36,219)	\$ (7,817)	\$ (24,920)	\$ (32,736)
BALANCE (Total Assets minus Total Liabilities & Net Responsibilities)	(\$7,105)	(\$27,720)	(\$34,825)	(\$6,820)	(\$24,304)	(\$31,124)

¹ Source: Fiscal Year 2004 Analytical Perspectives, page 37, Defense Fixed Reproducible Capital, Nonfinancial Assets.
Note: Overall details may not add to total due to rounding.

5. Unfunded Liability

The above chart illustrates a number that is beyond comprehension. It is taken from page 12 of the 2003 Financial Report of the United State Government. It reveals, unlike what most politicians tell us continually, Social Security is broke. As you can see from this document, the aggregate liabilities accrued by the United States Government in 2003 brought the total debt to over 26 trillion. (page 4 shows how the government’s considered solving this issue)

Solutions

- 1. Diversify among traders versus asset classes.** In the 3rd quarter of 2002 99% of equity funds lost money. While some lost less, those who were inverse the markets made money. It is imperative that money managers use tools that go inverse the markets at times.
- 2. Consider using a short only manager.** While this will absolutely lose you money in bull markets, it can work to your benefit in bear markets. For this reason you need to study history and many technical and economic factors. However, this tool gives the investor a way to grow your money in a long term bear market.

Feel free to send any question you may have to: doug@genadv.com

Solutions Continued

3. Buy Gold as an asset—While I would not recommend this asset unless you have an entrance and exit strategy, gold can benefit investors in the proper context. Even though as of this publication I am not recommending holding gold, it is something that I review weekly in consideration of the long term view(4-5 years).

4. Consider other currencies – While this does carry risk that **must** be understood before using this tool, holding dollars when the dollar falls sharply as it did from 2002-2003, is a risk most individuals do not even realize they are taking. For a great understanding of currency moves and bear markets, you should read, Balance Sheet Recession by Dr. Richard Koo. He is the Chief Economist of Nomura Securities in Japan today and started his career with the Federal Reserve in the 1970s. The Nikkei 225 averaged 38,916 in December of 1989. It closed at 11,278 on October 4, 2004.

5. Be content with less – The more inflexible you are with your current lifestyle, the fewer options you leave yourself in the long run. Enjoy the simple things today!

The three solutions given in the government study, Fiscal and Generational Imbalances: New Budget Measures for New Budget Priorities., Dr. Jagadeesh Gokhale and Dr. Kent Smetters, Policy Discussion Paper, Number 5, December 2003

1. Increase payroll taxes by 16.6% immediately making the totaling 32.9% between employee and employer.
2. Hike income taxes by 66% immediately.
3. Cut Social Security and Medicare benefits by 45% immediately.

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