

# Outside The Beltstreet

December 2004

## This Issue

- \$2.2 trillion since 2001 **1**
- Is it just chatter Mr. Kudlow? **2**
- Learning from past bubbles **3**
- Two views of consumer debt **3**
- Wave Three Down (Revisited) **3**
- Tops and Bottoms since 1997 **4**
- Another Perspective of loss. **6**

## Preparing for the Final

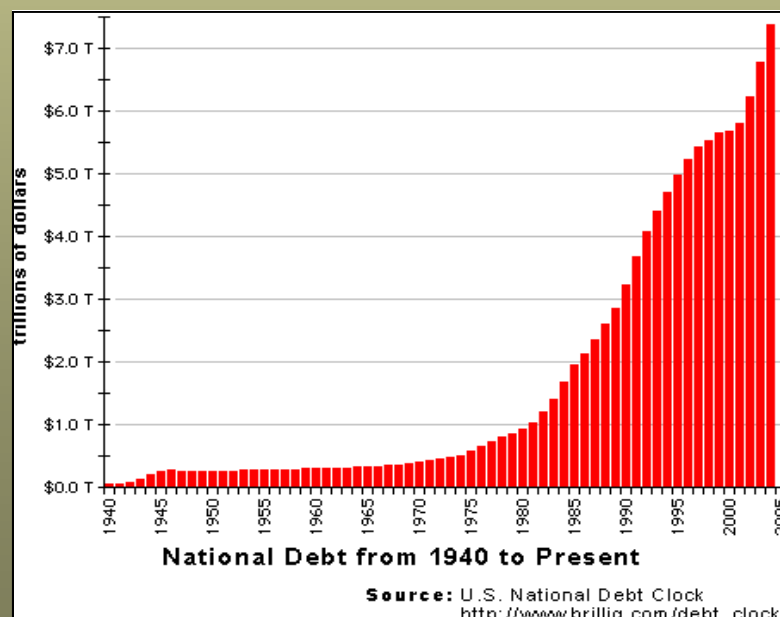
Like students getting closer to the final exam, we'd do well to review all that has occurred over the previous semester. Since the start of 2004 I've presented lessons I've learned on the "money game" and revealed the casino mentality that is still prevalent in the markets today. While our nation's currency has certainly revealed this fact over the last year by its decline, the stock and bond markets have acted like this was 1982 and the beginning of a boom was at hand. All perspective from the year 2000 appears to be lost in the mania of "eternal bliss".

Before we review the material for the final exam for 2004 (gleaning lessons to help us in 2005) let's take a quick look at some historical occurrences that have appeared just in this last quarter. We can then decide if these have **bullish** or **bearish** implications.

Our nations leaders voted to increase the debt ceiling by \$800 billion on November 18. Previously, it was \$7.384 trillion. Lest we forget about this little piece of financial information, let me remind us that legislation was signed on May 27, 2003 to raise the national debt ceiling by \$984 billion to the \$7.4 trillion we just passed. Similarly, just one year earlier (2002), the US Government had given approval to increase the debt ceiling by \$450 billion. So since the recession "ended" in November of 2001, we have increased our nations debt limit by \$2,234 billion (or \$2.2 trillion, if you like). No wonder our currency has flailed abroad.

## Points of Interest:

- National Debt
- Current Account Deficit
- Corporate Losses
- Insider Selling
- Historic Levels
- Wave 5 of 5
- Ingrained biases



## Preparing For The Final (continued)

The nations trade deficit for the month of October was \$55.5 billion, an increase of 8.9% from the prior month, which was the largest monthly increase in US History. The current account deficit reached \$166.7 billion in the third quarter of 2004, the largest quarterly deficit in US History. So when I saw an article from well known economist Larry Kudlow, who recently stated, "All the **chatter** about the twin budget and trade deficits forcing the Fed's hands is just **so much nonsense**,"<sup>1</sup> I thought to myself, 'Is he living on the same planet and in the same United States I am?'

We must remember, as we prepare for this exam, to look past what an economist says now, and gauge how accurate the economist was in the past and how much what is said is supported by the data. For Mr. Kudlow, the track record is good only during the boom years of the 1990's.

Consider the following comments by Mr. Kudlow in an interview in March of 2001.

"By 2010 [the NASDAQ] should reach 10,000..." and, "I've been on record for [the Dow to reach] 35,000 for a while."<sup>2</sup> Also, consider these comments from July 1999, "The Fed is not going to cut [rates] - The Fed does not have to raise rates. The dollar is so strong. King dollar is the strongest in the world."<sup>3</sup>

My issue is not the mistakes Kudlow made from 1999 to 2001, during the popping of the first bubble. I too believed Kudlow and men like him at the time. With the lessons of 2000 intact, to say that speaking of concerns over historical deficits is "**chatter**" and "**nonsense**", borders on downright recklessness. Consider the chart below. Has the problem of a growing trade deficits been something that we have only recently been able to see and understand? Is this really just "**nonsense**"?

**This is what makes studying for the 2004 final exam difficult. We must read past the answers given us by the "experts" and make sure they hold water.**

1. "Kudlow's Money Politics"— a Daily Blog, December 15, 2004
2. Interview in the "American Spectator", March 2001
3. An Interview on the "Jim Lehrer Online News Hour" July 21, 1999.

Profits from current production **decreased by \$55.9 billion** in the third quarter. Taxes on corporate income decreased by **\$17.9 billion** in the third quarter. Source— Bureau of Economic Analysis— **12/22/2004 Report**

<http://www.bea.gov/bea/newsrelarchive/2004/gdp304f.htm>

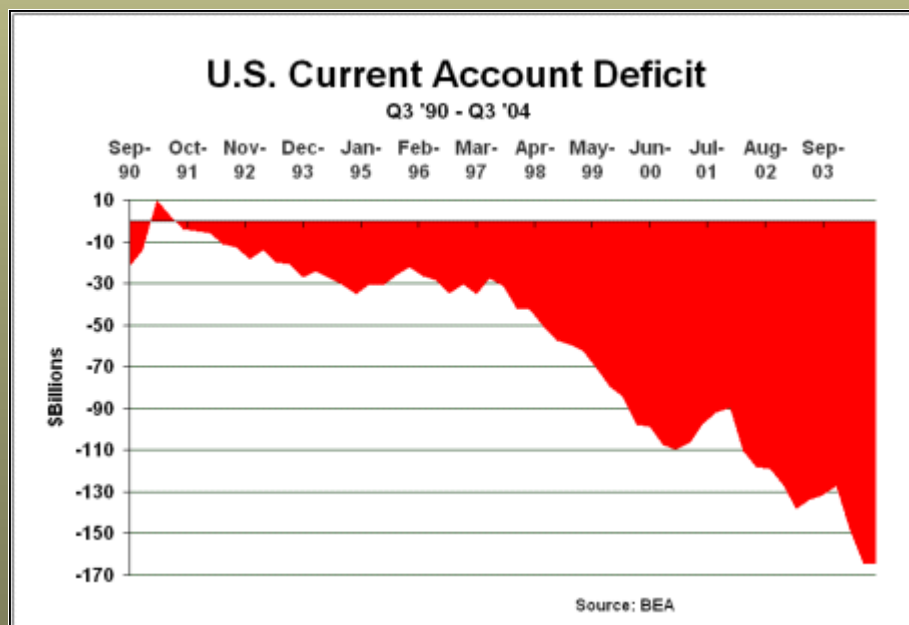


Chart from the Prudent Bear Website. December '04

## Technicals

	2004 Highs (Start of Wave III Down)	
	Date	Level
Dow Jones Industrial	2/19/2004	10,753
NASDAQ Composite	1/26/2004	2,153

The most recent levels show that these numbers have been slightly exceeded. More than likely this means that Wave III was not completed on these dates, but they are in the process of topping now as bullish optimism and other factors have taken us to an even "tighter rubber band". See next 2 pages.

### 2004 Final Exam- Quotes in History

"We have in fact searched through absolutely all the data that we can find on currencies, commodities, and stock markets and have found 27 bubbles. Unlike Chairman Greenspan, we have no trouble in defining a bubble: we arbitrarily use a two standard deviation event, the kind that would occur randomly ever 40 years. Predictably (at least for believers in regression to the mean), **all 27** bubbles broke and went all the way back to the preceding trend! To be equally predictable, the current bubble, which at its maximum inflation in March 2000 was the biggest bubble in American History, will have to pass through its trend of 720 on the S&P 500, currently at just over 1100 [now over 1200]. If it does not do this, it will be the first failure to do so in modern times."

Jeremy Grantham, "The Countdown Continues", **The October 2004 Quarterly Letter**, GMO LLC

**POINT-** "In recent years, banks and thrifts have been experiencing low delinquency rates on home mortgage and credit cards, a situation suggesting that the vast majority of households are managing their debt well."

Alan Greenspan, age 78, "The Mortgage Market and Consumer Debt" A Speech before the America's Community Bankers 2004 Annual Convention, Washington DC, October 19, 2004.

**COUNTERPOINT-** "Since 2000, mortgage borrowing has soared from \$4.8 trillion to more than \$7 trillion. That is more than \$600 billion a year. This compares with an increase during the prior ten years (1991-2000) from \$2.7 trillion to \$4.8 trillion, or around \$200 billion per year. Overall household indebtedness is up from \$7 trillion to almost \$10 trillion since 2000. On this sum, we estimate the American consumer has an annual interest bill of more than \$500 billion; a sum, by the way, that vastly exceeds his current income growth."

Dr. Kurt Richebacher, age 86, November 2004, The Richebacher Letter, A Monthly Analysis of Currencies and Credit Markets.

### 2004 Final Exam— A Few Small Stats

<http://www.treas.gov/tic/mfh.txt>— 12/15/2004 Report

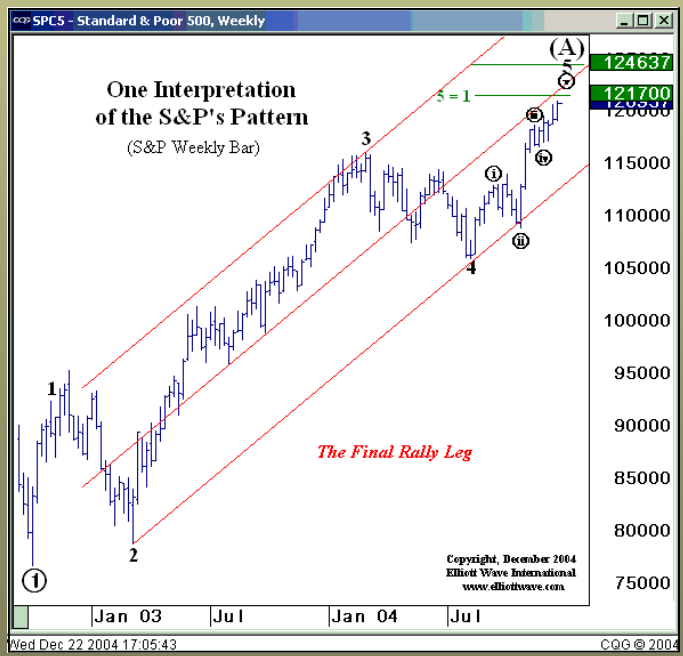
Amount of Treasury Securities	Oct. 2004	Sept. 2004	January 2004	Oct.2004 Percents
Japan	715 billion	720 billion	583 billion	38.5% of total
China	174 billion	174 billion	156 billion	9.3% of total
Total of all Major Foreign Holders	1,855 billion	1,843 billion	1,576 billion	China & Japan— 47.8%

The total Sales in November by stock market insiders was more than \$6 billion with purchases just \$130 million. This was the highest ratio of sales to buys since August 2000.— Source, **The Wall Street Journal**, 12/1/2004

## More Charts. What Historical Pictures!



According to Ralph Elliot's Wave Theory (developed in the 1930's), when you completed the 5th wave in a larger wave, the larger direction of the market would begin to move in the **opposite direction of the previous move.**



The charts above are from **Elliott Wave International**, December 22, 2004.

## More charts. Investing based on feelings. OK class. What does history teach us?



## I am independently minded. Really.

Last month I posted the Money Emotions Test. If you have not taken the test, I strongly encourage you to do so. If you are married, have your spouse take it as well, and if not, then have a close family member or friend take it. Then compare notes. It will not give you the answer of the "holy grail" to investing, but it will certainly reveal the worst enemy of any investor - their own emotions. In 2005 I will also address some THEORIES in the world of money, that have been around for decades, and show that they have serious flaws. Oddly, because we're unfamiliar with the original source, and because these theories are presented as fact, we suspect anything that opposes these THEORIES as highly questionable.

One thing that continues to fascinate me as I read and observe human life is how we react to information. In an article entitled, "Don't Confuse with the Facts" Dr. Drew Weston of Emory University found that after interviewing a group of individuals and asking them preliminary questions to see if they liked or disliked a person or organization, that their responses only changed by 1% based on evidence. In other words, adding the evidence only allowed the psychologists to increase their prediction from 84% to 85%. The participants were saying, "Don't confuse me with the facts. My mind is made up!"

So my hardest task is not finding data to support the fact that we are in a historical bear market; the data sources abound. It is much harder to break past years of instant bias and the constant battle of those "too busy to read" and thus individuals falling back on the labels such as "pessimistic" versus "optimistic" or "bullish" versus "bearish".

(The Source of Dr. Weston's comments were from the 12/1/2004 weekly free e-newsletter of John Mauldin's.)



“For I was hungry and you gave me something to eat, I was thirsty and you gave me something to drink, I needed clothes and you clothed me.....” Matthew 25: 35,36

What would we hope others would do, if we were in these pictures?

Please note: Information contained herein has been obtained from sources believed to be reliable but is not necessarily complete and accuracy is not guaranteed. Any market trends mentioned in this issue are not to be construed as investment or trading recommendations specifically for you. This report is for informational purposes only.

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