



Presidential Pretzel Logic
By Barry Strudwick

Some 75 years ago Baltimore's legendary iconoclast, H. L. Mencken held court from his row house in West Baltimore to discuss the woes of the world. Over beer, pretzels and cigars, the Sage of Baltimore and his cohorts would lament and lambaste the bumbling of the world's dunderheads. While perhaps not as witty or gritty, in the same spirit today, I occasionally convene with a cadre of free thinkers to discuss everything from the woes of the O's to the cultural significance of Hooter's Airline. While in this "no carb" age the pretzels and beer are no more, but by the time cigar smoke blues the room, we've resolved most of the world's extant problems.

To our newsletter readers

This newsletter was originally published on June 30, 2004 and as a service is now being released to the general public.

In a lull following a rousing discussion on the Islamic Jihad, I recently posed to my all-knowing confederates a question that had been nagging me for several months. "Regardless of whom you personally *support* in the November election, whom do you *think* will actually be elected?" Some what surprisingly, the consensus was near

unanimous, with even our resident liberal firebrands conceding the Bush/Cheney ticket would likely eke out a victory. I say *near* unanimous because when my turn came, I turned a few heads when I shared my premonitions: "*Kerry in an Upset.*"



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Three months later, I'll say it again and amplify: it won't even be close. Again, this isn't a question of "support", but rather what looks to the most likely turn of events. And what we'll likely have to live with for the next four years. Since the market tends to move ahead of the news, a Kerry election will likely be the single most important factor impacting your investments over the next six months. How could the Younger's reelection dreams go up in smoke so quickly? Simply, the *Iraq/Vietnam analogy* has eroded Bush's support in Middle America. Look at the popularity of *Fahrenheit 9-11* as a barometer of popular emotion. \$80 million in box office receipts and still counting reflects an emotional nerve clearly close to the surface in the heartland. Keep in mind if only 1 in 100 voters defect from Bush, we'll have a different result this time around. We suspect this threshold has already been crossed. While we mentioned the possibility of a Kerry election in our last letter, now is the time to consider the implications and start positioning for the

eventuality now, not in November. Looking for the silver lining in this cloud, the good news is that it likely sticks a fork in Hillary's presidential ambitions, but we'll save that discussion for another day.

So what would a Kerry – Edwards's election likely mean? From an investment perspective, in the short run, look for the stock market to shrug it off and the bond market to take gas. Why? Because the amount of liquidity already pumped into the U.S. economy before the election will take another several years to burn off. The bond markets will not be as forgiving as they will fear inflationary spending programs of the team that is already being dubbed "the most liberal in history".



Del Pacifico Beach Bar

Recent history gives us a good precedent. Do you recall back in 1991, how the economy was sputtering as the housing and real estate markets were hammered in the wake of the Savings and Loan collapse? Do you recall George the Elder and Jim Baker's solution? Remember the Resolution Trust Company? The idea was to first clean up the balance sheet of the banks and then create more jobs in time for the election with easy credit. They then shored up the banking system, a massive

bailout of the S&L's. And what happened? The jobs came too late, didn't they? And a virtual unknown, Bill Clinton, pulled a major upset.

But there is more to learn from this story than simply recalling the start of the Modern Moral Dark Age. While the media was fixated on Whitewater, Travelgate, Vince Foster, Jennifer, Monica, Marc Rich and half a dozen other scandals, do you recall what happened to the stock market? It soared, didn't it? Have you ever wondered why? Was there a new economic vision coming from the White House? Hardly. Remember how Newt Gingrich's Congress blocked virtually every Clinton proposal? Well, almost all. Clinton's memoirs remind us of his first encounter with a certain pizza-delivering intern was actually during Newt's "government shut down".

Costa Curious?.....

Why not join us for a weekend in Costa Rica?
September 10-13
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Please contact Harry for details at
1-866-4 NOLOAD

So if visionary policy from the Oval Office didn't spark the massive bull market, what did? Certainly globalization and the emergence of the internet were powerful factors, but the true catalyst was the massive pre-election liquidity Bush and Baker had already pumped into the economy. The long burning after-effect made the huge global expansions and the wild speculations in the internet and telecom all possible. Have you forgotten

those wild days when just about any 23 year old slacker with a scooter could raise \$50 million with an idea? That's too much money sloshing around. Similar conditions exist today as George the Younger is desperate to create jobs before the election. This will buffer any adverse reaction to a Kerry victory.

Radio Thought #107

Don't get "Bond- Barded" by rising interest rates! Higher rates would cause the market value of even "risk free" bonds to implode! Chasing yield today could have you yelling for help tomorrow!

From the [Mutual Perspectives Broadcast](#) April 25, 2004 on [WYPR 88.1](#)

Let's be clear here: we are not predicting a stock market rally, but rather saying that the risks of a Kerry election tripping a stock market fall are unlikely because of the amount of stimulus **already in the system**. Longer term, a Kerry – Edwards ticket would likely be very troubling to the stock market because of protectionist sentiments and grandstanding on international trade. Recall Kerry's vow to attack the **"Benedict Arnold companies"** who have moved jobs offshore. **Tariffs** won't be far behind on goods from China and India. Chuck Schumer (Dem – NY) has already proposed 25% tariffs on everything from China. Protectionism in an era of globalized economies will not be good for the stock market. But we have some time to watch this story play out.

But it's **a different story for the bond market**. The bond market will respond to a Kerry / Edwards Whitehouse with higher rates to offset the prospects of higher inflation down the road. And as the age old algorithm

of the bond market dictates: **Higher rates mean lower bond prices**. Even a "risk free" 10 year U.S. treasury will lose about 7% for every 1% rise in rates. This is why we're defensive on bonds right now.

Of course, this all begs the question of why we think **Kerry will pull an upset**. Do you recall the razor thin margin of victory last time? The math on this is pretty simple, if just 1 person in 100 had changed their vote, Al Gore would be sitting in the Big Chair today waiting for the pizza to be delivered. Just kidding, Tipper.



New roof lines on the horizon...

Do some empiric polling on your own. The next time you're out running errands ask a handful of working people two questions. Who did you vote for last time? And, who are you going to vote for this time? If 1 in 20 switches, you're beyond the polling "margin of error" and Bush has a big problem. If your experiences are like mine, you'll find a surprising number of former Bush supporters being swayed by the Iraq as Vietnam argument plus a stronger "anybody but Bush" sentiment than I would have suspected.

Another barometer? Look at the success the Democrats have had raising funds. Think about the people Letterman and Leno quiz on current events. Can we expect the same people who don't know who our vice president is to conceptualize a global war between Islam and Western civilization? Can they envision a war that does not involve discrete nation-states? Heck, do they know what Islam is? Do they really care as gasoline, the opiate of the masses, is cheap? However, the electronic media can repetitively force fed the analogy of the new Vietnam which will produce the predictable Pavlovian response. Repeat after me no exit strategy you are getting sleepyno WMDs another roadside bombing todayrepeat after me Iraq is Vietnam.....

Radio Thought #110

Oil is the opiate of the capitalist massesand Sky high oil costs could cause the Bush re-lection engine to freeze up in the heat of the summer

From the [*Mutual Perspectives Broadcast*](#) May 9, 2004 on [*WYPR 88.1*](#)

Likely already more than 1 in 100 working class voters have been swayed by the Vietnam analogy. The question is: "Can George win them back in 90 days?" Highly doubtful as long as the evening news continues the daily body count. The stirring of Vietnam memories will continue. In addition to erosion from the middle, we see additional erosion on the far right. We see a number of disaffected staunch conservatives likely to lodge "anti-republican" protest votes with the Libertarian Party candidate (Michael Badnarik). A lot of conservatives are upset about the budget deficit and the Patriot Act

which is seen as an erosion of civil liberties. Just as Nader was a pivotal factor in the last election, the 1% or so of voters who will likely defect in protest, could easily contribute to an upset. With the Nader vote down and the Libertarian vote up, the net advantage is to Kerry.

There are two wild cards we could see flipping this around. First is, Cheney stepping down from the vice president spot on the ticket (for health reasons) removes a popular target. Could Colin Powell as VP turn the tide? The second is, if a significant terrorist attack occurs on American soil before the election. We don't see either as a high probability right now. Regardless, now is the time to start preparing for the potential result. The downside if we're wrong? Likely not much. The bond market might rally, but at these low rates, it's not worth the risk or higher exposure.

What's happening on Eager Street

Last month was the last episode of ***Mutual Perspectives!*** After 13 years on the radio, last month we decided to hang up our microphones and ***retire from the airwaves!*** We'll miss having the opportunity to meet with some of the brightest minds on Wall Street, but not the frantic Tuesday afternoon deadlines! But after over 500 mutual fund mangers interviews, it was time to move on to more fertile ground.

All our new found "extra time" has already been filled up! And as always, we won't be at a loss for words. We've accepted an invitation to write a column for ***Costa Rica Today*** and also have started

a *new book project*. Our goal is to publish *“Dirt Simple!” next spring* which will share our insights and adventures in international real estate arena. Did I tell you about the timeZZZZZZZZZZZ ZZZZZ ZZZZZZBut we’ll keep you posted!

Speaking of real estate, our *private equity* activities have continued to grow as we continue to put together some very exciting new projects. Certainly, a lot of people are disillusioned with Wall Street and want alternative investments. Our latest project is called *“Costa Reit”* which is a *private land banking partnership* focused on acquiring large tracts of land in Costa Rica and other parts of Central America. The idea is to acquire land in the direct path of growth and sell to future developers who will be following the soon to be retiring Baby Boomers. Costa Reit has already targeted several very attractive properties and will be moving quickly. *Now is the time to get involved*. If you would like to find out more about it, call either Dan Somerville or myself.



View from the condos

Curious about Costa Rica? We have a great “no hassle” idea for you. Join us for our upcoming *“Global Opportunities Get-Away Weekend”* which will be October 7-12 in Costa Rica. The *GO Get-Away Weekend* will combine fact finding and fun! In addition to

Barry Strudwick’s discussion of new opportunities in global real estate, the *GO Get-Away* will feature an All- Star panel of speakers such as international investment manager *Michel Laporte* of *New Shore*, hard asset guru *Michael Checkan* of *Asset Strategies International* as well as real estate experts like *Mike Cobb* of the *Marriott Gran Pacifica Resort* in Nicaragua and *William Ramirez* who heads up the *Del Pacifico* project in Costa Rica. *Call Stephanie at our office for details. We’ll handle all your reservations!* We are strictly limited to 15 couples and this is filling up fast.

Adios Loyal Listeners:

After 13 years of Mutual Perspectives, we have decided to retire from the airwaves (for the time being at least). Our last show was Sunday, June 6; but don’t worry- we are certainly keeping busy!

Barry and Dan

And if all of this wasn’t enough Also ...slated for an October release is our first motion picture project Our “soon to be minor” ... straight to DVD *“The Curse of the Maya”* (think *Blair Witch Project* in the jungle!). It will be directed by David Heavener and we’ll keep you posted as production starts these months.

Now for some insights into what happened in our investment portfolios over the past 90 days and for the first half of the year. As always, if you want to ask any questions on this or share with us your

opinions, please feel free to give us a call to discuss your personal situation.

- 1) Earlier this year we went *against the consensus* of an “election year rally” and moved into a defensive overall allocation earlier in the year as we felt the economic recovery was not sustainable. Basically, a “recovery” that is fueled by people borrowing against the inflated equity of their homes is built on a shaky foundation at best. Historically, the great economies of the world have been built by people saving and investing, not spending and consuming. Beware the impact of the slowing of the re-fi engine! It’s this juice that has been providing the empty calories for the consumer spending engine. Higher interest rates will slow this down! Then what happens to the recovery?



Costa adventure anyone? Join Barry and Dan for an Ultra-Lyte flight over the rainforest

- 2) With the U.S. stock market up only up 1% for the first six months of the year, our conservative allocation of only 25% to the U.S. stock market proved to be a good call. Of these holdings, most are small and mid cap “value” holdings

and more conservative core holdings. *Royce Micro-Cap* is up 6% YTD.

- 3) Our market neutral holdings are now 35% of holdings which had excellent returns for the first half (about 6%). The *Oppenheimer Real Asset* (QRAAX) fund led the way with a 13% return. This funds which replicates the Goldman Sachs Commodities Index (GSCI) should continue to do well in an environment where government policy is to stimulate consumer demand. This will in turn drive up the price of commodities and natural resources, especially with China’s surging demand for raw materials. We don’t see this changing in the short run.
- 4) We’ve tried to add a growth component to our portfolio by increasing our holdings in emerging market stocks. Clearly the *Genie of Capitalism* is out of the bottle in *India, China and Russia* and can not be put back in. Our economy is also now addicted to the *low cost brain and brawn pools* they provide to wrench out the “productivity” gains so gleefully reported in the press. In a nutshell, there will be continued growth and reliance on all the emerging markets. We will use this as an opportunity to dollar cost average and building long term positions.



Interior of the new condos

- 5) The merging market stock markets stubbed their collective toes this quarter with China, Russia and India all falling for different reasons. However, we see this as an opportunity not a problem. Looking the factors more closely, it's evident they are more "one time" political / emotional moves, rather than based on the long term economic trends. The average of all emerging market funds was down 9% for the quarter but history has shown these markets can make up this amount of ground in a couple of days.
- 6) While a lot of fuel has been dumped onto the U.S. stock market, the much ballyhooed "election year rally" has yet to ignite. The reason is the "over-hang" of global supply. We hate to sound like a broken record, but the reason remains the same fundamental issue we have pounded the table about for the past 5 years. The real impact of *Globalization* has been to increase the *Supply* of virtually everything faster than new *Demand* has been created. *When supply is greater than demand, prices fall.* When prices fall, *profits will also fall*, unless you are able to cut costs even faster. If profits fall, so do stock prices.
- 7) The easiest way to cut costs is to use lower cost foreign labor, which means fewer jobs in America and lower demand. Unless, of course, Americans are encouraged to borrow against the equity in their homes to finance current consumption. But this artificial demand is like feeding empty calories to the economy. When the sugar rush burns off; the machine will need to be fed again. Where will this come from?
- 8) Why is Supply suddenly greater than demand? You can build a new factory in 18 months, but it can take up to 18 years to create a new consumer. Until the new consumers emerge from the incubators we call the emerging markets, severe price competition is the likely result as excess goods are dumped on the more mature consumers in the developed economies. This is especially true of the U.S. where low interest rates have encouraged our consumers to borrow against the equity in their homes to swoop this up.
- 9) Speaking of cutting costs, the latest statistics show that the rate of transfer of white collar jobs is actually 40% higher than previously projected. Next year 860,000 white collar jobs will move offshore. Outsourcing today is not about "man power" but low cost "brain power". For the cost of one engineer in Detroit, you can hire 3 in China or India and have enough left over for a room full of call

center operators at \$100 a month. This trend is accelerating.

- 10) Here's a *scary stat* to ponder: According to the New York Times, if every job in America was "outsourced" to China, there would still be a surplus of labor in China. Think about that one for awhile and then reflect on the potential for "wage" inflation in the United States over the long term.

Radio Thought #106

Poking at the Real Estate Bubble
.....Is the wealth of your Castle
largely an illusion ? ...What if interest
rates start to go up ?

From the [Mutual Perspectives Broadcast](#) May 9,
2004 on [WYPR 88.1](#)

- 11) Rather than lament the hollowing out of America's economy, we've instead opted to take the "glass half full and filling" philosophy of investing in emerging markets. The logic here is quite simple and compelling. Every job "outsourced" "from the U.S. creates at least one more job somewhere else in the world and new wealth is created *outside the United States*. Emerging market stocks are now 15% of our portfolios.
- 12) New wealth in an emerging market initially creates a real estate boom as people upgrade housing and shopping centers are built. This play is greater than the initial stock market move. We learned our lesson with *Ireland* in the mid 90's. When the internet unlocked the English speaking workforce in the late 90's Ireland boomed but *the real profits* were made in the real estate

market, not the stock market. The Irish real estate market is up 250% since 1998. The same thing is happening right now in Central America and India. In 2000 there were 12 shopping malls in India, there are now over 300! One of the few ways to play this theme is the *Alpine Global Real Estate* fund which has done nicely this year with a return of 5.51 %.

- 13) While India is beyond our reach for *direct real estate investment*, *Costa Rica* is very viable. It also has the advantage of benefiting from the retiring Baby Boomers who are seeking second homes. 2005 marks the year in which the first wave of Baby Boomers reach age 58, which is the inflection point for early retirement. As a direct way to play both the globalization and graying of America themes, we have formed a private land banking partnership called "*Costa Reit*" for our friends and clients. The idea here is to lock up choice larger tracts of land which we believe are in the path of future development. Costa Reit will invest in Costa Rica, Nicaragua, Panama and Belize. *If you would like to discuss participating in Costa Reit, please give me or Dan Somerville a call at the office.*
- 14) You'll recall that we exited our *U.S. real estate* positions last year. This sure looks like the right call as the average of all U.S. real estate funds is down 5% so far this year. We continue to be very negative

towards domestic real estate which continues to look like a bubble to us. On the commercial side, occupancy rates are weak and average rentals are falling. On the residential side, it looks like the recent rise in interest rates might have put a stop to the spiraling market price increases. A hiccup here could easily ripple thru other areas of the financial markets as well. Keep a close eye on this!

- 15) Which way interest rates? The boogey man of deflation is still with us which argues for the long term trend to drop. However, in the short to intermediate term, concerns by people focused on rising commodity prices will lead to an uptick in interest rates as concerns about “inflation” are thrown about in error. This is why we’re cautious about bonds.
- 16) Confused? Well, it’s really simple. Inflation, red hot consumer demand here and industrial demand in China has driven up the prices of raw materials. However, while very visible, **commodity prices** are actually only a small part of the total inflation equation. Much more important is the **price of labor**. In a typical good, materials might be 10% of the final cost and labor 50%. So even if commodity prices are increasing but labor costs are falling, will we have “inflation”? We don’t think so. Labor is the dominant force here.
- 17) Here’s why: recall our example of the cost of an engineer in Detroit versus India. As new labor pools around the world open, the price of manpower and brainpower will fall in the United

States. This will more than offset the short term increase in commodity prices. We’d also argue the commodity price increase might also reverse when the re-fi fuel burns off and U.S. consumer demand falls off.

- 18) **Our conclusion** is inflation fears are overblown at this point and deflation (falling prices from oversupply) remains the real threat. A knee jerk reaction to the recent commodity price rises could lead our politicians to fight the wrong economic woe. **This would be a serious mistake at this point.** Fortunately, we believe that the Fed finally understands this. So look for the press to whip the inflation horse, but also look for the Fed to be slower in raising rates than the general public might expect.
- 19) **Inflation and Deflation** are both problems caused by regulating **the supply of money**. One is the problem when you print too much money. The other is when you don’t print enough. At the end of the day, you cannot globalize the world’s economies and not also create a global currency. **This is the core global problem we are facing right now.** Unfortunately, the Fed has neither the tools nor the mandate to regulate a global currency.
- 20) Likewise, no elected officials in Washington we can think of have the **political stomach** to touch this lightning rod. As the Left labor sympathies force it to grow protectionist and the right has

alienated many allies with the Iraq war, this problem politically becomes more difficult to fix. Can you imagine your favorite politician coming out and saying “Hey guys, let’s work with the French, Russians and Chinese on replacing the dollar with a global currency”. They’d get it from all sides, Rush, O’Reilly and even CNN.

21) A Kerry- Edwards “landslide” might be interpreted as a mandate for change. Given the strong labor ties to the Democratic Party, this would likely stoke the fires of protectionism and tariffs. This would be very negative for the stock market if it is accompanied with control of the House and Senate. We’ll keep an eye on this.

Conclusion:

Right now, we’re pretty comfortable where we’re positioned. The fuel of the re-fi booms is starting to fizzle out, but we’ve already moved to a more conservative stock allocation and increasing our market neutral holdings. We’ve also already exited the domestic real estate markets and reduced our U.S. bond exposure. Counterbalancing this to a degree, we’ve positioned for longer term growth by establishing emerging markets holdings.

At the start of his term we said that President Bush was dealt a very tough hand of cards to play. Over the past 4 years, while I disagree with his personal philosophy and decisions in a number of areas, overall he has done a good job in navigating some very tough waters. This being said, the average American still doesn’t understand the key underlying issues and will likely decide to

shuffle the deck. Initially this should not have a major impact unless it’s deemed as a “mandate for change”. An uptick in protectionist sentiment is something to be wary of.

M. Barry Strudwick

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ABOUT BARRY STRUDWICK...

Barry Strudwick serves an international client base of individuals, investors and entrepreneurs designing and implementing wealth enhancement and protection strategies for over 25 years. *For private consultations Barry Strudwick & Dan Somerville are available to meet with you. Please contact them to arrange a meeting. We can be reached by calling*

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