

April 2006



Currency Concerns & Pogo's Ponderings

By Barry Strudwick

This Newsletter was originally published March 31, 2006 to the clients of Strudwick Wealth Strategies as our "second quarter report". After a 60 day delay, it is now being distributed as a service to our readers. Please feel free to contact Barry directly if you would like an update on our analysis or inquire about our advisory services.

Good News!

We're off to an excellent start to 2006 as our Globalist Strategies continue to outperform.

While the Dow and the S&P 500 also had a good quarter, as you've come to expect the path we followed was quite different. Even though commodity prices are settling back after the spike-up post Katrina, our positions in the *Emerging Markets* (in *India* and *Latin America*) surged ahead with returns of over 40% over the past 90 days. As this type of rally is neither rational nor sustainable, we're happy to pocket a portion of our profits while the rest of Wall Street is just beginning to stampede thru the "Third World" turnstile.

Globalization is not just a ripple effect, it's a potentially violent hurricane which is just beginning to batter the economies around the world. If disruption creates change, this can mean new investment opportunities. Over the past several years we've been positioning our

investments to not only weather the storm but profit from the changing landscape as well. But you have to position yourself before the storm, not after it. Wal Mart started shipping plywood as soon as Katrina appeared on the radar screen, not after she hit. Don't you wish you had "gone long oil" before Katrina? A similar magnitude *economic storm* is brewing right now.

Last quarter we outlined "**Five Waves to Surf**" for the next 5 years. These investment themes are the distilled essence of "*How*" we are currently investing. But underlying these specific thoughts is the core concept of "*Why*" these investments make sense today. The simple reason we're about to face *The Perfect Economic Storm* is because "*Supply is greater than Demand*" on a world-wide basis.

Such a simple statement, but its implications are much more profound and perhaps disturbing than most people comprehend. In the past 10 years the central fulcrum underlying all market based economies, *the crucial balance of Supply and Demand*, has started to shift. We started detecting this movement in 1997 and have been adapting our strategies since then. Most of Wall Street is still ignoring the implications. For example, have you heard rumblings "*Inflation*" is about to pick up? A classic example of *status quo denial*, because "Inflation" only occurs when "*Demand is greater than Supply*", not vice versa. Confused? Just look around, if "inflation is coming", then why is the price of everything from cars to computers falling? *Right now* we should all be paying some extra attention to what this means and how it can impact our wealth.

Why? Because we are witnessing a shift in the global economic environment of epic proportions. This is a once in a life time change which was unleashed by NAFTA, GATT, the Internet and the global telecom

revolution. A radically different playing field is emerging not only for us, our children and grandchildren, but for us ***“almost retired” Boomers*** as well. This is more than being able to get cheap toys from China. A soon to be reckoned with by-product of these currents is the global shifting of the ***Haves*** versus ***Have Nots***. While we all hear a lot about the new millionaires in China and India, few Americans truly recognize a huge amount of this wealth is being siphoned away from them. ***Many of yesterdays’ “Haves” will be tomorrow’s “Have Nots”***. In particular I’m talking about our soon to be retiring Baby Boomer. Anesthetized by a constant barrage of media spin, very few are even aware their wealth is going offshore. It’s the old story of gradually increasing the temperature on a lobster so it doesn’t even know it’s being cooked. A massive amount of the wealth of the U.S. is flowing out and nobody seems to care. The ***only immediate remedy*** to preserving your wealth is to hedge aggressively against the rapidly eroding purchasing power of the U.S. Greenback. ***Commodities, Foreign Real Estate and Emerging Market Equities*** are all tools to do this.

Random Thought # 107

***We owe foreign governments \$3 trillion.
To repay this debt our fearless leaders in
Washington will either:***

- A) Raise taxes or***
- B) Devalue the currency?***

Which one will you bet on?

Since the last time we spoke, another thing we know with absolute certainty is that every single Baby Boomer is now 3 months ***closer to retirement*** than they were at the beginning of the year and likely not any better prepared. Over the next 5 years, many will awaken to the harsh reality of the ***“Zombie Retirement”*** or the retirement of the living deadwith an

eternal low paying part time job “Will that be paper or plastic, *M’am?* Is this a political powder keg where our Boomers trudge onto retirement at age 65 only to find Golden Pond was a just mirage? Here’s a frightening thought What happens in a democracy when the Have Not’s outnumber the Have’s and they vote? We’ll find out soon enough. This fuse is now 3 months shorter.



An income producing offshore asset...new condos at Del Pacifico!

Here’s another question we should all be asking ourselves:

From an economic perspective, just what is the competitive advantage of the United States in a globalized economy?

Education? Healthcare? Political Stability? Innovation? Technology? Telecom? Wall Street? It’s clearly no longer manufacturing. Is it still the “service” economy? Then why have all the customer support and technical support industries shifted offshore in less than 5 years? Remember in the 80’s when the Japanese were the apparent threat to our manufacturing sector? Our response was “the Japanese can’t innovate” and we’d point to our cultural colonization of the world as we exported our movies and TV shows. Twenty years later, we no longer have a manufacturing sector and I haven’t heard the “Innovation” argument in a long time. Let’s face it, when the best export you can point to is Mickey Mouse, it’s hardly time to rest on your laurels.

If we can't find a solid answer to the competitive advantage question, the second question to ask is:

In a world with open markets, why should the United States continue to retain a disproportionate share of the world's wealth?

Going back to the Katrina analogy, during the Cold War era the United States had a system of levees which helped protect our wealth. In our newly globalized world, the levees have been breached. Not only is the U.S. being flooded with cheap imports, but our capital and wealth is free to flow out as well. Every empty oil freighter or container ship that returns to the Middle East and China represents a portion of our national net worth being shipped offshore. Sure, we've heard this for the past 30 years and we've always seemed to muddle thru. But what has changed is the underlying competitive environment which has suddenly been leveled.

The *speed* at which the forces of globalization are *eroding* America's position of pre-eminence is both startling and amazing. In the emerging markets you can forget the image of Indiana Jones and his bullwhip. With wi-fi, a laptop and a cell phone, anybody can be a virtual multi-national corporation. Did you know there are already 250 million cell phones in China? Last summer I negotiated on a multi-million dollar transaction while seated in a wi-fi enabled *Denny's* in San Jose, Costa Rica. Want fries with your shake? Absolutely incredible!



Coney Island or Costa Rica? Your choice!

Millions of budding entrepreneurs armed with cell phones and laptops are scrambling to fight their way up the economic ladder right now. Educated, hungry and now connected, all they're lacking is experience and they're learning on the run. Don't underestimate the skills, talents and ambitions of these people. Only the seriously naive will rest on the "***Because I am an American***" legacy entitlement. This won't last for even another 10 years, tops. Adam Smith's invisible hand is silently taking the chips right out of our pocket and spreading them out around the world. Yet few seem aware that the increase in the market value of their house doesn't reflect an increase in their wealth, it's mainly a fall in the ***global purchasing value*** of the U.S. dollar.

Don't get us wrong, our intent here is not to bash America, but rather open your eyes to a changing world. These changes are happening faster than we had even imagined even 6 months ago when even then we were startled by the pace of changes. ***It is clearly time to act more pro-actively.***

Where there is change, there is always opportunity. Recognizing the reality of the environment is the essential first step in developing a successful strategy. Our job is to ride the tidal surge and not fight the storm. Since money will always flow to the highest after tax return we just need to position ourselves accordingly.

If money can get a higher return invested outside the United States, it will be attracted as if by a magnet. While this tide is already running strong, it's ***still early*** in this process. Rather than passively lament the inevitable, our job is to find the right opportunities ***now***. It almost goes without saying these opportunities will not likely be in either the U.S. stock or Bond markets. The falling dollar and a weakening competitive position

make both of these unattractive. “**Hard Asset**” investments will at least preserve your current purchasing power in an environment that argues for a debasing currency.

A secondary current of this major trend is **the politics of the graying Baby Boomer** which is now becoming a real factor and not just an academic observation. This could shift **the political balance of power** in the next election. It certainly will do it to the ones that follow. Early skirmish lines are beginning to shape up as employee health and **retirement benefits** continue to get slashed across America. Major employers such as **IBM, Verizon and GM** have slashed or frozen benefits with “global competition” cited as the major factor. Remember the days when young college grads took jobs with major U.S. companies “for the benefits”? Today only 2/3’s of the S&P 500 companies still offer health insurance coverage. Want to see something even scarier? At last tally, 42% of all workers 21 and over have **no retirement plan**. Even worse, this was up from 39% just 5 years earlier. Wanna connect those dots?

This is not an academic argument that won’t impact you. It has immediate investment implications. Why? Because this year, 2006, the first Baby Boomers just turned age 60. In 5 years they will be age 65 and feel entitled to retire. But on what? Even worse, those that have saved over the years are being **silently robbed** by a dollar that is losing its purchasing power. What happens when our retiring Boomers arrive at Golden Pond only to find it was **just a mirage**? These people vote. If this perception / realization grows, it will impact the next presidential cycle. Despite Washington’s attempts **to spin it another way**, this is both an actuarial and political reality that can’t be swept under the rug any more.

What does this mean from an investment perspective? Look for increased “isolationist” **anti-free trade movements** and perhaps **currency restrictions**. But we don’t think the

Genie can be put back into the bottle. Start opening up your thinking to even a broader picture of **new opportunities globally**. Everybody outside the U.S. already is. Please feel free to **call and discuss** new options that go beyond “global” mutual funds.

It seems that our message has been spreading which has helped us grow over the past several years. As we’ve grown we’ve been adding new people to our team. **Andrea Sutter** is playing the role of our staff juggler as she works with me on anything I can throw her way on a daily basis. **Melissa Long** is the voice on the other end of the line when you have administrative questions on your investment account. **Tim Dodge** is now learning the ropes on client relations and responding to information requests. And of course, **Stephanie Green** is heading up our private equity group and **Leslie Hoblitzel** is coordinating the logistics of our far reaching enterprises. **Smilin’ Dan** is still helping set up our new accounts.

We really appreciate the **referrals** we’ve been receiving as these are always the best

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new clients. If you have some friends that you think would benefit from our investment strategies, please feel free to make an introduction and we'll do our best to take care of them.

Enough of our view of the world from 50,000 feet. Let's talk about the nitty gritty and how this all has translated into actual investments and results over the past 3 months.

- 1) We've had an exceptionally strong quarter with our positions in the emerging markets leading the way. Our *Latin American* positions are **up 60%** and our positions in *India up 40%* over the past 90 days. Clearly this is ahead of any real economic growth and we have already **taken some profits** during the quarter and will trim these once again.
- 2) The biggest profits are in what's now called the "**BRIC's**" which is the new acronym du jour standing for *Brazil, India and China* as the Big Three of the emerging markets. We've already **cut positions** by over 1/3, basically representing the profits we're recently captured.
- 3) Even after these reductions, our **Emerging Market** holdings at over 10% are still **significantly higher** than a "typical" advisor's allocation which rarely ventures above 2.5%. We suspect there is still plenty of room on the upside with the herd on Wall Street just starting to lumber in this direction. We suspect every portfolio manager on the Street is starting to put some emerging markets "window dressing" into their portfolios. Since they all tend to invest in the same 50 or so stocks, this sudden up-tick in institutional interest causes stock prices to spike quickly.
- 4) Our experience over the past 15 years with this sector is that sudden run ups of 50% to 100% gains or more are frequently

followed by 50% to 70% downswings which is a great time to buy again. So don't take our reduction in these positions as a change in philosophy, but rather as a **tactical decision**.



The new condo's and Town Center at Del Pacifico in Costa Rica. Buying dirt or bricks and mortar offshore is the newest hard asset investment.

- 5) As most of you know, we love *Latin America* and have been heavily invested in both marketable securities and real estate there for along time. Because of their heavy exposure to natural resources, our Southern Cousins have been the prime beneficiaries of the explosive growth in China. We are growing more concerned by the **shifting of power towards the left** in a number of countries most notably *Nicaragua, Venezuela, Peru, Bolivia* and also Brazil. **Wall Street apparently is ignoring this for now**, but the Herd has been known to change direction and stampede out the door very quickly. We have taken some profits in our Latin American positions as a precaution. Recall the 50% plus 2 week drop in India just last year. When Wall Street sneezes in the emerging markets, it causes a hurricane. This is a much bigger issue for marketable securities and mutual funds then it is for real estate.
- 6) Our positions in **international real estate** thru marketable securities have also excelled with gains of about 14.5%

YTD. Look at this as both a globalization play as well as **a hedge against a falling U.S. dollar**. As long as the global economies expand and the dollar weakens, we should do very well here.

- 7) As the standard of living improves outside the United States, the local real estate markets typically experience a boom *before* the local stock market. Witness the incredible real estate boom in **Ireland** when the Internet unlocked her highly educated English speaking work force. **Private Equity** partnerships in international real estate are still an excellent way to get more exposure to this sector. Please give me a call if you'd like to discuss these opportunities directly.
- 8) Second, foreign real estate is a **natural hedge** against a falling dollar. Does any one really think that eventually we don't have to pay the piper for the massive deficits we're incurring? The classic solution to this is to debase the currency and repay the debt in devalued dollars. This might fix Washington's problem, but it leaves all of us retiring Baby Boomers unknowingly footing the bill. The loaf of bread that was \$1.00 will soon be \$1.25 or even \$1.50.
- 9) Is this **"inflation"**? Not really. It's a **loss of "purchasing power"** of your money and not a price increase caused by more demand than supply. If your money had been stored in grams of gold and not a "fiat currency", the price would have remained the same. **Anticipate** this occurring at a much faster rate than it is reported in the press over the next 5 years. **Preserve** your purchasing power by shifting a significant portion of your net worth to investments that "hedge against a falling dollar".
- 10) Understanding this distinction between "inflation" and a **de-basing currency** is very important. Washington is spinning the **"Inflation Boogey Man is coming"** to

unify the masses to fight a common enemy that can be blamed on powers outside the country. The **real enemy** is the currency debasement coming from within the Beltway. Isn't repaying China all those trillions of dollars easier with cheaper dollars? Think about this one for awhile. As our long lost friend **Pogo** once said **"I saw the enemy and him is us"**.

- 11) The important point to understand about our national policy right now appears to be to allow (encourage) the Dollar to drop in purchasing power. For Boomers post age 50, this is a very important issue as the earning years decline. We strongly recommend **increasing allocations to "hard assets"** which will preserve purchasing power in the wake of a weakening currency. Draw your own conclusions here, but if you get spun around by Washington and the Press on this one, your investments will all be facing the wrong way.
- 12) The anticipated (inevitable?) decline in the purchasing power of the dollar has been one of the major reasons we've been heavily overweighted to **commodities** for the past several years. The **second reason** is that the global economic boom has caused prices to spike as **supply bottlenecks** developed in the distribution chains around the world. We continue to see this as the correct long term play. Our inclination right now is to **ride out** any short term volatility caused by shifts in energy prices.

Random Thought # 108

Since 1983, the Dow is up 1200% and gold is still under \$800. Even after gold's two year rally, which one do you think is overvalued? We think gold still has room to glow.

- 13) We continue to maintain our position that oil under \$50 a barrel is unlikely as the combination of increased demand from **China and India** as well as a weak dollar will both continue to support these levels of prices. It's *wishful thinking* that the surge in China is going to stop anytime soon.
- 14) Perhaps the **absolute worst investment** we see right now is what the average investor thinks is the safest. We're talking about bonds, especially **U.S Government bonds**, Agency bonds and also Muni bonds. Our allocation to U.S. dollar denominated bonds is under 15% versus about 40% for most advisors accounts. The reason here is simply with a 5% interest rate you aren't getting paid for the two largest risks you're taking: rising interest rates and a falling dollar.



But still less risky than the stock market!

- 15) The rationale here is very simple. Do you think long term **interest rates could rise** by 1% in the next year? Most people would say "Yes, it's quite possible". Did you realize that if interest rates rise by 1%, a 30 year U.S. government bond loses about 13%? Are you willing to accept this "quite possible" for a "maybe" return of 5%?
- 16) And that's in the most favorable scenario where the dollar holds its purchasing power. How attractive is that 5% yield **if the dollar falls** by 5% in purchasing power? What about that loss of 8% if interest rates rise by 1%? Do you see why
- we're not excited? I think the only people who will argue with us are bond salesmen.
- 17) We remain **bears on the U.S. stock market** and remain allocated at about 25% (versus 60% for most advisors). Additionally, our holdings remain heavily in favor of **small and mid cap companies** and some energy holdings. This strategy has again worked very well as our positions are up about 9 %.
- 18) As we go around our global **Monopoly** board with the profits we took in the emerging markets, we've recently acquired the staid and stogy "**Water Works**" as in Water Resource stocks. Every country has its own version of a water crisis and demands on clean water will only increase with economic growth and prevailing demographic trends. Is Water hitting the tipping point as a scarcer resource? These positions are currently about 2.5% of most accounts and we will build these over time.
- 19) We have continued to build our **Gold positions** and were again rewarded with 7% gains as the glittery stuff reached a 22 year high. The last time gold was this high was when we were unraveling the debacle of the Carter years and the collapse of the Rust Belt. Gold is a much more emotional play than our other commodity holdings. While typically less than 5% of most commodity indices, we have our positions as a hedge against an **eventual international currency crisis**. Most accounts are at a 5% holding here.
- 20) The same week that Gold broke \$525 an ounce for the first time in 23 years, the Dow broke 11,000 for the first time in 5 years. Need a barometer for which one is telling the true story on which way the wind is blowing? Consider this, since the last time gold broke \$525 per ounce in

1983, the DOW is up 1,200%. With Gold still well under its \$800 high, our wager is Stocks have more room for “*reversion to the mean*” and Gold has *room to glow*.

21) Our *Alternative Energy* positions also excelled in the quarter with *Ballard Power* finally popping for a 75% return and we’re adding more to our alternative energy positions (2.5% in most accounts). This is a highly volatile sector and is vulnerable to the same Wall Street “me too-ism” as the Emerging Markets. We suspect a wave of new money to come this way as the reality of a world with long term \$60 oil starts to set in. This means the “break even point” for all of these new technologies is suddenly a lot lower with oil at \$60 a barrel than it was at \$30.

22) *Common sense* tells us that the U.S. and Europe *cannot continue* to rely on oil controlled by *militant Islamic interests*. Given the events of the last 4 years (and especially the escalation in the past 6 months) to think otherwise would be *Ostrich-itis*. We are seeing signs of increased global strife as *all economies strain* under \$60 or \$70 oil. How do you profit from this friction? We think *Alt-Energy* stocks is the logical play here. This is more of a *geo-political hedge* as we suspect the true economics are still 10 years out.

23) While we are hedged against a falling dollar, what about getting more aggressive and actually *shorting the Dollar*? Such bold moves have bankrupted more than one all-seeing, all knowing Nobel Prize winning guru, so it’s well beyond our comfort zone. This being said, if we were to see a 10% or greater drop in the U.S. stock market, we suspect our new Fed Chairman Ben Bernake might just start running the printing presses. Remember Bernake suggested last year dropping “bushels of dollars from helicopters” as a

cure for deflation. Can you see why we’re concerned with Washington taking the easy way out of a global monetary crisis by debasing the currency?

24) Excuse me as I repeat my quarterly rant about the risk of investing in *domestic real estate*. We remain concerned about *tumbling dominos* caused by a sharp slowdown in the U.S. housing sector. Since 2000, the housing market impact on the economy has grown from 4% of GDP to 8%. Clearly this is fueling the “consumer economy”. What happens if interest rates spike up, cutting out new home financings? If the housing market cracks, where will consumers get the cash to continue consumption?



Every aging Boomer’s dream – the Tiki Bar on the beach at Del Pacifico.

25) If the U.S. consumer stops floating the world economy with deficit spending, do you think China and India are ready to pick up the slack? We don’t think so either.

26) A number of people are taking the *Alfred E. Newman* “*What, me worry?*” approach here. They figure the Fed “can’t let the housing market collapse”. The problem with this bit of wishful thinking is the Fed doesn’t control the mortgage markets. The market level of these rates are set by the *global bond markets*. Now suppose *China* decides not to hold as many U.S. government bonds. A shift here will force up U.S.

interest rates to attract alternative foreign buyers. Oops, there goes the housing market and the jet fuel of re-fi's for keeping the economy spending. As for us, we *are* worried.

- 27) We are no longer the lone voice in the wilderness on this one. The *Sage of Omaha* (Warren Buffet) has recently opined that ***"The rest of the world owns \$3 trillion more of U.S. government bonds than we do. Pretty soon there will be a big adjustment."*** When Warren issues a warning, it's a pretty good time to start paying attention.
- 28) What could happen to the *value of houses*? Using U.S. 30 year government bonds as a surrogate for a 30 year mortgage, a 1% rise in interest rates could cause a 13% decline in the market value of our housing stock. A 2% rise and an awful lot of mortgages are "under water". ***Poof!*** There goes all that *phantom equity* up like smoke.

Random Thought # 109

The political sea change we sensed starting after Katrina in September 2005 continues.

Now is the time to start thinking of the investment implications and shifting your strategies...not after the elections.

- 29) And with no "equity" and "non recourse" loans, what happens if people start leaving their keys at the Bank's door? No problem, because the Bank doesn't own the mortgages anymore. They've all been "securitized" and the *Boomer's likely own them* thru the mutual funds in their 401(k) plans. ***Gotcha!*** Sometimes you can't seem to win for losing.

- 30) Need another opinion on this? Noted international investor Marc Farber recently said ***"The world has a glut of both cell phones and PCs, but by far the biggest over supply is the U.S. dollar"***. If *foreign governments* start dumping U.S. bonds, this will result in higher interest rates. The logical play here would be to ***short the U.S. long bond*** market which you can also now do with the ease and convenience of mutual funds.
- 31) The ***third domino*** to topple would of course be the ***stock market***. The rationale here is that if consumer spending stalls, so will earnings and stock prices of a "consumer economy". This is just part of the reason we are very suspect of the U.S. stock market.

All of this being said, we see great opportunities at hand if we acknowledge which way the wind is blowing. Our biggest revelation is that the pace of this change is continuing to accelerate. It is already much stronger than what even we anticipated last year or even 3 or 6 months ago. Our strategies at Strudwick Wealth Strategies are limited to working with "marketable securities" as part of our "discretionary" advisory services. More aggressive alternatives, such as direct foreign currency investments, international real estate partnerships or the holding of physical precious metals are beyond what we feel appropriate to use our "discretion" to include in your account. However, I am always available to discuss these with you, assist you where I can and make introductions when I can't.

Barry Strudwick
March 31, 2006

For more information please call 410-727-6444 or email us: invest@noload.com

ABOUT BARRY STRUDWICK...

Barry Strudwick has served an international client base of individuals, investors and entrepreneurs for over 25 years. For private consultations Barry Strudwick & Dan Somerville are available to meet or talk with you. Please contact them by calling (410) 727-6444 or via e-mail at invest@noload.com



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