



## **Shorting Las Vegas Before the Herd Turns**

**By Barry Strudwick**

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***This Newsletter was originally published June 30, 2006 to the clients of Strudwick Wealth Strategies as our "third 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.***

As we reach the half-way point of 2006, we're pleased to say most accounts are up comfortably ahead of the S&P 500 which was only up 2% and the NASDAQ lost 7.5% for the same period.

While we gave back some paper profits from our April high water mark, we're optimistic we're positioned to continue to outperform.

So, how is it we up again bested the Pretty Boys of Wall Street? Common sense and simply looking at what's going on around us. Globalization has not only changed the rules of the game, the pace of changes is accelerating. Going forward, we suspect the recent turbulence

is just the advance winds of what could be an extended rough spot for the U.S. stock and bond markets. However, shrug off the bearish frown, because for the global investor, there is always a bull market somewhere!

Globalization's continued disruption of the world's economies will create some excellent investment opportunities, but only if you're not trying to sail against the winds of change. "Conservative" investors seeking a "safe harbor" should be forewarned: traditional defensive strategies will not work in this environment! Why? The classic defense of "moving to cash" is the exact wrong strategy when we're facing a falling U.S. dollar. Last quarter (pre-meltdown) we warned a 10% market correction could trigger the Fed to start printing money. Be on the lookout! If and when the Fed decides to start running the printing presses over-time to reduce the burden of our international debt, "**Cash is Trash**".

The pro-active alternative to the "bomb shelter" mentality is to position away from a falling dollar. **Hard Assets** such as commodities, international real estate and precious metals are all logical plays here. But to truly profit here, you have to employ an all but forgotten secret technique called "independent thought and action"! This might sound cynical, but right now Main Street has been lulled to sleep by the gentle coo-ing sounds of Wall Street and is still ignoring the long term implications of Globalization. For "**The Few**" still able to think and act

independently, this is a huge market inefficiency which can be exploited for profits. However, ***“act”*** is the operative word here, not *“see,” “agree,” “think,” or even “understand”*. To profit requires breaking free of the group think comfort zone. ***Now is the time to commit to acting, not just agreeing!***

### ***Globalization Redux***

Since we first started noticing the unexpected impacts of globalization on the U.S. financial markets in 1997, every three months, we have paused to “connect the dots” to share our perspective on the net impact of an interconnected financial world. Over time, several observations and their ramifications have become very clear. Perhaps the greatest impact of NAFTA, GATT, the Internet and the Tele-Com revolution is a huge spike upward in global supply of virtually everything. In fact, the global economy is suddenly producing more than the world’s consumers need. The ripple’s set off by this simple phenomena now threaten to become a tidal wave, potentially swamping the world’s newly intertwined economies. A walk thru any mall should provide the all the empiric evidence you need to see *....Everything is on sale all the time*. This bad news because oversupplies mean price wars, lost jobs, falling profits and eventually falling stock prices. But most Pundits and Pols seem to be ignoring the obvious signposts, instead telling us to be on the

look out for “inflation” or a world where too much demand is outstripping supply.

In part 9-11 is to blame. In the aftermath of the Twin Towers, Washington soothed the national psyche with the anesthetic of “cheap money”. For the past 5 years, the U.S consumers have been induced to valiantly (and vainly) attempt to rebalance global supply and demand by hollowing out their home equity. As we have said before, this is a tragically flawed strategy of historic epic proportions. But our global adventure isn’t Homer’s *The Iliad*, it’s more aptly called *The Idiot* featuring Homer Simpson on a shopping spree at Wal-Mart. Even brain dead Washington should know no amount of U.S. consumer spending could ever create a sustainable global equilibrium. When the shopping spree ends we will be left to deal with the very long term consequences of a huge debt burden and the reality that vast amount of wealth has already been siphoned out of the United States.

### ***Random Thought #110***

#### ***Does opportunity knock twice?***

***With Oil north of \$70 and the Mid East set to explode, alternative energy stocks dropped by about 15% during the recent “Market Meltdown”. This was even greater than the Energy Markets indices. Now is a good time to start building long term positions.***

This isn't another pundits prediction if what "might" happen. It's already occurred ..... Poof! ..... Our national net worth ... to the tune of a few trillion dollars .....has already been depleted and is in bank accounts in China and Japan. The saddest part is we have received virtually nothing productive in return. We suspect it will be another 5 years before the Armchair Academics acknowledge what we're telling you today. However, simple observation and common sense should vouch for what we're saying. While the damage is done on a national level, the good news is you can still mitigate the impact to your **personal net worth** by acting ahead of the Herd's acceptance of the reality. Ignore the "Static Quo" of Wall Street's spin machine and act today on several major trends that will be with us for 5 or 10 years.



The "Don Patrol"

Barry & William survey Construction at Del Pacifico

While perhaps not exactly "happy time news", here are some of the Big Realities we think it's important to both acknowledge and act on:

- 1) **Oil Prices are not going to drop back to \$30 a barrel.** Do you really think China and India are going to decrease their demand for energy ever again? Have you looked at the declining oil reserve numbers worldwide? While the rest of America is living in denial and hoping for the miracle of *the seamless segue* from fossil fuels to alternative energy, **the Few** will accept reality and invest ahead of the sadly deluded **Herd**. What happens to the American Dream if our very finely tuned global logistics machine is disrupted or is forced to run on much lower octane fuel?
- 2) At the same time, we're also facing a looming **Boomer Retirement Crisis** which will have huge economic, social and political ramifications. This isn't theoretical anymore; in 2006 the first Boomers turned age 60. Fast forward past the Wall Street spin of medical care and retirement homes as "investment themes". Focus on the reality that the 50 million strong Phalanx of Boomers is getting older every day. The problem is that few are getting any richer. From an economic perspective, likely less than 25% of them (and this is being very generous) have saved any where near enough for retirement. Just how is this aging horde of people actually going to

be able to retire? Since the dot com stock market crash, the S&P 500 is essentially right where it was in 2001 and all the working stiffs are all now 5 years older. Is there enough time for “the magic of compound interest” to pull the rabbit out of the hat? We don’t think so. You can punch on a calculator all day long, but its very difficult to make up for 5 lost years especially when your time horizon is less than 10 years. Now compound this with people who have been spending away their home equity for the past 5 years. Need to add a little insult to this injury? What happens to the market value of homes when interest rates rise? Just like a 30 year bond, for every 1% rise in rates they should drop by more than 10%! If mortgage rates rise by 2%, is all of suburbia under water? And for the final kick in the shins, a falling dollar will make all those cheap foreign imports more expensive. Since we no longer make anything and every thing is imported, this will put a real crimp in the old retirement budget! We hate raining on your Golden Years parade, but the practical implications here are down right frightening. We’re facing 50 million Boomers who feel they are “owed” a retirement income, but haven’t saved enough to buy their place on the sun. *Here’s a heavy*

**question:** *What happens in a democracy when the “Have Nots” outnumber the “Haves”?* This fuse is short and it starts in the next election cycle. Doesn’t it make sense to “globalize” at least a portion of your net worth before we actually have to find out?



Internationally acclaimed architect, Leon Krier, during his visit to Del Pacifico

- 3) *Is the glass half empty or half full?* Even as wealth is being siphoned out of the United States, new fortunes are being created elsewhere around the world. As jobs are outsourced from the United States, thousands of new factories are springing up in India, China and Latin America. This is creating a new international middle class. Look at what happened in Ireland in the 90’s. Once the Emerald Isle was unlocked by the internet, Ireland experienced a tremendous boom over the next decade. Where were

the real profits made? In *real estate*, not the stock market. The new middle class first upgraded its standard of living. The same thing is happening all over the world right now from Costa Rica to Turkey. Investing intelligently in the growth of emerging markets via real estate and to a lesser extent their still emerging financial markets should prove to be profitable.

- 4) And what about that pesky *National Debt*? The long term down trend is *glum for the Greenback*. When we owe \$3 trillion dollars to other governments, the very strong incentive is for Washington to decrease the burden by debasing the currency. When a politician is given the choices of either a) raising taxes or b) letting the dollar slide; which one do you think he'll choose? Our common sense strategy is to shift investments *now* to minimize the impact of the declining dollar. This can be done via real estate, commodities and precious metals. Diversifying away from a falling dollar isn't a question of patriotism, it a necessity of prudence. Rising interest rates indicate the day of reckoning here is moving ever closer, but the opportunity to move ahead of a crisis still exists.

### *Random Thought #111*

#### *Duel Standards?*

*In July, The House passed a new bill designed to crack down on internet gambling. The "Unlawful Internet Gambling Act" exempts state lottery & horse racing. Is this more about protecting Las Vegas and our leaky tax system than protecting our citizens from vices?*

If you agree with any or all of these trends are inevitable, the impact will be much less traumatic if you invest ahead of The Herd. Given this backdrop, here are some thoughts on how we've been approaching this unusual convergence of events:

- 1) Most of our accounts remain *up between 6% and 8%* for the first 6 months of the year. While down from our high water marks in April, we're very well diversified and well positioned.
- 2) Last quarter we warned emerging market stocks had leap-frogged economic reality. Accordingly, over the first 4 months of the year we reduced our holdings in *China, India and Latin America* by about 50% which proved to be timely. We'll be on the look out for another entry point, but not quite yet.

- 3) We remain tilted heavily in favor of ***energy, commodities and natural*** resources. These positions total about 50% in most accounts. The rationale here is two-fold:
  - 4) First, world wide demand for ***energy and raw materials*** will continue to grow. Since supply of energy and resources tends to be somewhat fixed in the short term and demand is rising, this should mean prices should also rise. Over the past several years the *New York Times* and *Wall Street Journal* have repeatedly predicted the stalling of the Chinese economy and the resultant collapse of commodity prices. We just don't see this happening on its own without a major catalyst. There is simply too much momentum. The genie of capitalism is out of the bottle and the Chinese are not going back to ***rice and rickshaws*** any time soon. Since we don't see Demand flagging, pricing for commodities should remain strong until Supply can catch up. It takes years for new supplies to hit the markets as new reserves have to be discovered and new infra structure built to bring it to market.
  - 5) Second, natural resources and commodities tend to ***protect your wealth*** in a period of a ***falling dollar***. For example, if the value of the dollar drops by 25%, the price

of a bushel of corn or even a ton of tin will go spike up by 33% even if there is no change in either supply or demand. This isn't really a "profit" but a preservation of purchasing power. Commodities are a very easy way to diversify away from a falling dollar without having to invest "offshore". Our commodity investments remain up about 5% so far this year even after the recent market turmoil.



**Oz on the horizon?  
No, just new houses at Del Pacifico.**

- 6) The only realistic up-setter for commodities is a dramatic ***global economic recession*** decreasing worldwide demand for all goods and services and decreasing demand for raw materials. But wouldn't this hammer all market sectors not just natural resources? The harbinger here would be sharply higher interest rates world wide. We'll keep an eye out for this.
- 7) The ***elephant in the room*** is how our massive international debt has placed the Dollar in a very

precarious position as an international store of value. When you owe \$3 trillion to foreign governments, Washington's temptation will be to repay the debt with cheaper dollars by debasing the currency. For centuries the Chinese have been known as shrewd business men. Do you think they will passively submit to be re-paid back with cheaper dollars? If China decides to dump the buck, rates on Government bonds would need to rise to attract new buyers. The ripple effect here would be higher mortgage rates in the U.S. and a real estate recession. This is a situation that needs to be monitored closely. We have already reduced our U.S. real estate holding. Once again, we recommend getting out of variable rate mortgages and lock in a fixed rate.

8) While this cuts across our conservative cloth, a strong argument can be made for aggressive investors to actually **leverage** their dollar denominated assets and use the funds to diversify away from the greenback. Recall how borrowers profited from Inflation in the 80's. Please feel free to call and discuss this further.

9) Now let's take the **China – Currency** situation one step

further. Most folks privately admit a conflict with China is possible down the road. But what most haven't figured out is that the conflict has already started! The battleground is **monetary not military and the first skirmishes of the new Cold War have already started**. Forget about Iran and North Korea's missiles and whether they can deliver a nuke to L.A. China already has its finger on the trigger of an economic neutron bomb which could cripple the U.S. economy and leave the infrastructure intact. All they need to do is stop buying U.S.

Government bonds or dump their existing holdings. Not only would interest rates immediately spike up, causing a recession, but the ultimate impact could be **far nastier** if the U.S. dollar's special position as the de facto global currency is challenged.

### ***Press and Podium***

***Here are some of the upcoming events to catch Barry's latest thinking on Globalization***

- ***Investment Advisor Magazine (July 2006)***
- ***Offshore Conference in Puerto Rico (October 2006)***
- ***The Gathering in Costa Rica (November 2006)***

[Click here for the complete listing!](#)

- 10) Is this a *real threat*? You can bet your bottom dollar on it! In fact, it's already happening. China is on a buying binge of energy and natural resources reserves all over the world right now. And how do they pay for it? Every time you read about China buying natural resources in another country, they are selling their U.S. treasury bonds to finance the purchase. Recall last year's attempted acquisition of *Unocal*? Doesn't it make sense to be doing the same thing ourselves and diversifying out of dollars?
- 11) Compounding our anxiety is the *jingo-ist rhetoric* from our normally more thoughtful and intelligent colleagues. More than one has glibly said the U.S. should simply default on our sovereign debt or go to war with China. Does this macho-speak reflect a growing realization of our actual limited options and possible plight?
- 12) *Alarmist*? If so we're not alone. Last month S&P's bond rating unit issued a warning that U.S. government debt could be downgraded from its "AAA" credit quality by 2010 if the current account deficit is not addressed very soon. For the mathematically challenged, that's less than 4 years or 1 election cycle away! Do you think the Chinese read the *Wall Street Journal*?
- 13) The *dual dilemmas* of rising rates and a declining dollar make investing in *U.S. Bonds very unattractive* at this time. Remember: a "risk free" 30 year U.S. government bond loses about 13% of its market value for every 1% rise in interest rates. Not exactly the type of risk /reward ratio we're looking for. *Second*, if the U.S. dollar falls in value, U.S. government bonds lose global purchasing power. Need another reason to stay clear? The mess over at Fannie Mae and Freddie Mac.
- 14) We are maintaining our holdings U.S. bonds at very low levels of approximately 15% of assets. International bonds, about 10% of assets, will benefit somewhat by a falling dollar, but still subject to the risk of rising interest rates. The net here is likely very modest returns. Again it bears repeating: *Bonds are not a safe harbor in this climate.*
- 15) What about good ole *U.S. stocks*? With less than 25% to this sector, we are very cautious here. Since we are already at our overall minimum holding for stocks, we will not likely reduce total holding any further despite what we see as deteriorating market conditions.

Our emphasis remains on small and mid-cap “value” styles which have outperformed their larger “blue chip” brethren by a cumulative 40% over the past 5 years. Despite the Press trumpeting the return of large caps, our small and mid cap “value” holdings have outperformed the Blue Chips by about 5% so far this year.

However, since 2001 the “Price to Cashflow” ratio of large caps has improved from 30X to about 15X closing the disparity in relative valuations. We’re not ready to shift away from our successful Small & Mid cap strategy quite yet, but we are evaluating our options.

***Random Thought #112  
A Cool Idea!***

***Did you know the weather in August is actually milder in Costa Rica than in Washington DC?! Why don't you escape the summer heat and join us at our Gathering Weekend?***

- 16) As if we need something else to get depressed about, ***global energy supplies*** are depleting faster than ***Alt-Energy*** is riding to the rescue. The odds are at least 1000 to 1 we’ll have a ***seamless segue*** as we exhaust out of our finite supply of fossil fuels and experience the Utopia of infinite quantities of

cheap renewable energy sources. To put your faith in this Hollywood ending is ***dangerously naïve***. The likely scenario should be continually escalating energy prices as reserves get scarcer. This will ultimately alter our life styles. Any short term disruption at all will be disastrous to our “just in time” economy. However, our overall complacency has opened a window of investment opportunity. When this crisis eventually gets politicized, the inescapable result will be for both the Government and Wall Street to throw obscene sums of money at any possible solution. The ***“Alternative Energy Manhattan Project”*** could be the next “dotcom” frenzy as stock prices will race ahead of any actual real earnings. Cynics that we are, investing ahead of a potential Wall Street ***“fad du jour”*** with a Government spending turbo-charger is an excellent opportunity. But the first step is to get invested in a broad range of Alt Energy stocks **now** when valuations are relatively low. Earlier this year we started building our initial positions which are now about 5% of most accounts. Somewhat surprisingly, the Alt- Energy sector has been hit over the past several weeks. This might be presenting a buying opportunity to increase our holdings here.

17) Looking for a hedge against a global recession? How about investing in the (rapidly depleting) essence of all life? **Water!** We have also been adding to **Water Resources** holdings which we do by investing in a broad basket of about 35 companies focused on the potable water and the treatment of water for consumption. With the rapid worldwide industrialization and population growth, we see Water as a recession resistant industry with above average growth prospects. Even in a global crisis situation, we still need water. This is a long term theme and we are building our positions gradually over time. These are currently about 3.5% of most accounts.

18) Over the past several years we have seen more investors interested in “**alternative investments**” or **direct private investments** ranging from international **real estate** to **biotech** to even **motion pictures**. Because these are generally higher risk investments and also illiquid, they are only appropriate for “**accredited investors**” with a 5 or 10 year investment horizon. We are working on several projects that might be of interest.

19) With the dollar falling, **international real estate** has been a solid place over the past several

years. We believe the aging of the Baby Boomers adds some extra relish to the appeal of international **resort** real estate. Our first land banking partnership has now closed after acquiring over 1,000 acres of Pacific coast properties in **Costa Rica**. However, don't despair! A **second fund** will be forming late this summer. For investors looking to get in early on a condo or a house, we also have opportunities here. The economics are about the same, so it's largely a matter of preference. Please let me know if you'd like additional information when it's available.



Over the river and through the rainforest

20) With life so fleeting, shouldn't we all also have some **fun** while investing?! How about **making movies**? Over the past several years we have also been involved with two motion picture projects. One is finished and the second is about to start shooting next month.

21) **Curse of the Maya Update**.....last year's film

venture, starring Todd Bridges and David Heavener, is now being distributed in 7 countries around the world ! We've just learned it is being bundled as a 2-Pak in France with the grand daddy of Zombie flicks the original "Night of the Living Dead" for the 30<sup>th</sup> Anniversary edition. U.S distribution rights are about to be finalized so you'll be able to get your very own copy soon. This investment is closed, but the prospects look good.

**Our next trip to Costa Rica?  
Join us for the Autumn Gathering!  
November 9-13 2006**

**To make reservations, please call  
Leslie at 410-727-6444 or email her  
at [leslie@delpacifico.net](mailto:leslie@delpacifico.net)**

22) **Lights, Camera, Action!** Filming is set to start next month for **Costa Chica** our new action adventure film of *Baywatch meets Magnum PI in Costa Rica*. The casting call has already gone out and legendary former pro-wrestling star Rowdy Roddy Piper is already on board. Other offers have gone to B- stars like Don Johnson, Eric Roberts, Linda Blair and (yes, he is still alive) ..... Jack Palance. We'll see who needs the paycheck right before filming! We'll complete production by August in time for

the big annual film distribution markets in the fall. **There are a couple of \$25,000 units left and you can do this in an IRA account!** So, if you've ever wanted to get into the movies, now is your chance! Call me if you would like to get onto the silver screen!

23) Speaking about something that could be a movie script, but is real today .....Have you been reading about the raging epidemic of antibiotic resistant "**flesh-eating**" **bacteria** in hospitals? If you want another crisis to lose sleep over, just Google the term "MRSA" which is the acronym for Methycilin Resistant Staph infections. This is the "**Super Bug**" you've likely heard of in hospitals, but there is now a variety that is found "outside" in the community. These are very nasty and are cropping up everywhere. We've been working with a bio-tech company called **Intralytix** which has come up with a naturally occurring remedy called "phages" (google the term) for this. It's so exciting the FDA has just green lighted this company to go straight to human trials. The company is bringing in **new investors** to finance these trials. Give me a call directly if you'd like to discuss this opportunity directly.

The world is always threatened by at least a dozen Bogey-Men that seemingly threaten our existence. Remember Y2K and SARS? Most of these get resolved, but we also think there are serious challenges to making Globalization work. We also think the classic American Dream is in danger of disruption. Regardless of our opinions on the solutions at the *societal level*, we do see these as creating investment opportunities at the *individual level*. Please let me know if you have any thoughts on any of these issues.



Barry Strudwick  
July 1, 2006

P.S. We appreciate the *referrals!* We especially value these because your friends are most likely to “get” our philosophy. If you have someone who you think we should get to know, please pass on our number or better yet, bring them by to visit.