



Nero, Fetch Yer Fiddle!

Barry Strudwick
Editor

These thoughts were originally shared with our private clients in early January 2008. They are now being shared, unedited, 60 days later to stimulate thoughts on these issues. These thoughts are considered general in nature and not specific investment advice. Please feel free to share your comments with us at www.theglobalistmonthly.com

Let's shake off the recent frostbite in the markets and take just a moment or two to bask in the sunshine as our *Globalist* strategies had another ***exceptional year*** in 2007! Most accounts were up significantly over 12% versus the S&P 500 which was up only 2% and the DJIA which was up 4%.

In a business where besting the averages by just 1% or 2% is just cause for chest thumping, we're pleased with last year. How did we best the mighty stock pickers and their multi-million dollar research departments again? The short version is pretty straight forward: we ***pro-actively*** positioned for a falling Dollar, rising

Energy costs and an overpriced bond market. We then ***protected our gains*** in the fourth quarter by slashing exposure to financial stocks and the more speculative emerging stock markets. It sounds simple now, but most of these calls were against the conventional sentiment and it's very difficult for most advisors to break away from the herd.

Donning our swami robes, our crystal ball for 2008 sees the Dollar remaining under siege, Energy demand (and prices) continuing to surge and the financial market ***contagion spreading*** from the Bond market over to the Stock market. Also, Washington will rush to the rescue with the populist pabulum of interest rate cuts that will ***worsen the longer term inflationary pressures***.

Not a pretty picture, we understand, but the key is to stay a step ahead of the spiral. Profits can be made by investing proactively not reactively. After the storm passes new investment opportunities will emerge from the wreckage. For example, for the past three years we repeatedly warned that bonds were not a safe haven and in fact were riskier than stocks. After the recent bond market meltdown, it's almost time to re-evaluate. In the past month or so, "spreads" for Junk bonds have increased from 1.5% to 5.5% over the T- Bill rate. Similarly, in the near future we will find some ***gems at dime store prices*** sifting thru the rumble pile of the real estate, housing and financial services sectors. Again we caution, these are in the future. Now is not the time to try and "catch a falling knife."

So much for the 2008 Big Picture, what about the tsunami swamping the markets in the first 2 weeks of the year? I can give you some small comfort, you might have

noticed in your year end statements there is more “cash” in your accounts than in the past 5 years or so. The reason? In Late December, I woke up with one of those old “funny feeling in my bones”. Concerned the bond market crisis would spread over to the stock market; we made the very difficult decision to take taxable gains in 2007 by cut back our positions in both the U.S. and also the “emerging markets” before year end.

Before you develop the mental image of me doffed with my turban, crystal ball and a throbbing big toe, allow me to explain. In late November the “sub prime” mortgage morass started to *spiral out* to the far bigger and more important “commercial paper” markets in both the U.S. and Europe. Commercial paper is the grease that keeps the gears of the international banking system lubricated. Without this, international trade grinds to a halt. While mortgages are collateralized by real estate, the commercial paper market is ultimately historically, based on the strength of the big banks’ balance sheets. It boils down to a game of confidence that you’re pretty darn certain that *Citi, Merrill or UBS* is good to cover a 60 or 90 day loan. When up for renewal, these were almost automatically “rolled over.” But this fall, while everyone was trying to pretend the debt crisis was “contained” to the mortgages, there was a wooly mammoth in the room named *Citigroup* that was getting too odiferous to ignore. While Citi has a huge capital base of \$35 billion, it also has as much as \$300 billion of “off balance sheet assets” some of which were only worth 20 cents on the dollar. The sheer size of Citi’s potential problems was starting to *freeze up* the global banking network. Banks didn’t want to lend to each other because they weren’t sure of the quality of their counterparts balance sheets.

For us, the severity of this hit home in December, when the foundation of the small investor’s safe harbor, the money market account, started to *show cracks*. Buried in the back pages of the financial press were reports of large fund houses and brokerage firms such as Legg Mason, American funds and dozens of others scurrying to arrange massive credit lines to support the sanctity of their money market accounts \$1.00 net asset value.

There was even a “*run on a bank*” when Florida state employees withdrew \$15 billion in 2 weeks from a state sponsored money market fund when it appeared it would “break the buck” and redeem shares below \$1.00. Wall Street’s Black Rock was called in to engineer a rescue but only after 50% of the assets fled. Was this shades of 1929?



India's Cooperstown for Market Pundits

Meanwhile, back in the Heartland, the national media was focused on the important issues of the day such as Britney Spear’s 16 year old kid sister getting knocked up! Not to be an alarmist, but it makes you want to shout “*Hey, Nero ! Go fetch yer fiddle, thar’s a party going on!!!*”

It was eerie. In the midst of the worst banking crisis in at least 50 years and not

only is America ignoring it, but for some reason the stock market is as well! Then came the catalyst which would prove to be **the bubble popper**. HSBC, the global banking behemoth, bit the bullet and decided to clean up their “securitized debt” problems all at once. This effectively torpedoed Citi’s efforts to create an international industry led “super conduit” rescue fund. Without industry support (collusion) to maintain the shell game of swapping bonds to each other, the inevitable result was for Citi, Merrill and the others to fess up to their losses.



Reeling it in....a sailfish from the Pacific Ocean

Realizing billions in losses means a massive erosion in the capital base of the entire banking and brokerage system. This month Citi wrote off \$15 billion and Merrill \$8 billion, **the largest quarterly losses in the history of the stock market**. Since every dollar of losses decreases there capital base the same amount, this has set off the recent **Sadie Hawkins Day scramble** as Citi, Merrill, JP Morgan, UBS and Bear Stearns all arranged shotgun weddings with the **Sovereign Wealth Funds** of China, Saudi, Singapore and almost any one else who could write a check with 9 zeros. Citi has been almost as shameless as Britney Spears, going to the altar twice in less than 90 days. And we suspect, they’ll be back again as their losses are likely much higher than admitted

so far. Already over \$100 billion industry wide has been raised with our guess being this is about ½ of what will be needed.

The bottom line is the situation is as bad as we’ve seen in 20, 30 or even 50 years and **likely to get worse**. While it’s sometime easier to put a simple label on a complex scenario, calling this the “sub prime crisis” is a **gross over-simplification**. Right now we are in the early to mid stages of fighting a global financial crisis which is like a multi-headed hydra. The domestic “sub prime” mortgage loan problem is just a sliver of the bigger tangled mess.

The over-heated **real estate market** is now cooling off worldwide and not just in the U.S Bank of America and JPMorgan stepped in with bail outs **Countrywide and WaMu**. But it’s not just in the U.S. where real estate prices are falling; it’s also England and Europe where **Northern Rock** has been a highly visible bank casualty. The mortgage mess is a catalyst for a much larger and more serious crisis of confidence in the entire global banking system which has rocked the foundations of the world’s largest firms.

Now Washington has gotten into the act and is fluttering around massive stimulus packages and also interest rate cuts. It shouldn’t take a research department staffed by 28 years olds with million dollar bonuses to tell you giving \$800 to every man, woman and child in America to spend at Wal-Mart will have absolutely no effect restoring confidence in the global banking system. If too much money and too much spending was the source of the problem, more of the same is not the cure. But what else would you expect in an **election year?**

Now that I’ve absolutely crushed my soapbox by ranting and stomping my size

10's , let me say **2007 was actually a fantastic year** both here on Eager Street and also in Costa Rica where I'm spending about 1 week a month. With broadband and a Blackberry, it's really no different than working from Baltimore.

While some people wonder how we get it all done, the answer is it requires a great team which **Leslie Hoblitzell** has been the key in assembling over the past 5 years. **Mike Torino** is now taking a larger roll in overseeing daily administrative operations, freeing me up for more research and strategic planning. Then there are my three angels. **Stacey Murray and Melissa Long** who work with me to the investment accounts to keep things flowing smoothly and **Candice Martin** has the thankless job of dealing with my constantly changing priorities, deadlines and travel plans. As for the more exotic and international ventures, **Stephanie Green** stays at least one step ahead of me whether it's helping **Del Pacifico** grow into an international destination resort or our latest movie project. To help her out, **Ken Hall** has joined the team to help crunch the numbers and count the beans and **Tim Dodge** is focused on property management. And our International Men of Mystery, Smilin' **Dan Somerville and Harry McDonough** are helping global thinking Boomers learn about opportunities at Del Pacifico and Costa Rica. It has been over 5 years since I first wrote about "why international real estate" makes sense for a retiring Boomer. Let me know if you might want to arrange for a small group to discuss our latest thinking in your home town.

Last but not least, 2007 was a banner year for our ventures on the **Silver Screen**. A film I invested in personally won "Best Picture" at Sundance (**Joshua**) and at the other end of the spectrum, the ultra low-

budget film I produced (**Dawn of the Living Dead**) got distribution into Wal-Mart which accounts for 40% of U.S. DVD sales! The irony? It's starting to look like **Dawn** might end up with a higher ROR than the critic's fave acclaimed **Joshua** which had the misfortune of opening the same weekend as **Harry Potter!** Was it P.T. Barnum who said you could never go wrong under-estimating the taste of the American people? Needless to say, a sequel **Baby Fritter** is in the works!



Spanish Colonial style of La Prada

Let me also add our really deep appreciation for continued support thru **referrals!** As you know we really market by "**word of mouth**" and really don't have a "sales" team. To keep growing, we need you to keep us in mind. So, if you come across a globally oriented person seeking investment help, please ask them to call !

Now onto some specific points on last year's performance as well as some **pontifications and prognostications** on what we think is in store for 2008.

- 1) **2007 was an excellent year** with most accounts up between 12% and 15% versus the S&P 500 up only 2% and the NASDAQ up less than 1%. The keys to our success? Pro-active positioning to profit from both a **falling Dollar** and also **rising energy prices**. We also had

great year in the *emerging markets* (up about 30%) and also alternative *energy* (up about 55 %.)



Feeling the stretch of morning Yoga by the Pool

- 2) **Going forward:** Anticipate a continued decline in the Greenback and continued upward pressure on *Energy* but the increasing global banking crisis could impact the *liquidity* of world markets, *changing some of the dynamics*. In simple English, this means at the national level, if/when the Fed cuts interest rates to “stimulate” the economy, then the Dollar will fall. This is very predictable. The *wild card* is on the international level, where turmoil and a lack of confidence in the banking system could cause *global liquidity* to contract with unpredictable results.
- 3) Our guess is if/when global liquidity contracts, *hedge funds and private equity* funds might be among the first to feel the squeeze and be forced to sell off their most liquid speculative holdings to reduce leverage. This could deflate oil and commodity prices but also

the hyper-hot markets of India and China which have had triple digit returns over the past several years and are selling at nose bleed P/E ratios. With China’s stock market up 600% over the past 2 years and India up 550% and a global financial crisis brewing, *now is the time to step aside and let greater fools step to the table and play the game*. Overall the Emerging Markets were up 33% last year and some sectors fared even better. We’ve taken most of our profits as we had an excellent year here with positions like *India* up 35% and *Latin America* up 12%.

- 4) The December reduction in the emerging markets was the second reduction this year and largely closes out our holdings. We view this as a *tactical rather than a strategic decision*. You might recall we were up to 20% exposed to the emerging markets 2 and 3 years ago when they were off everyone else’s radar screen.
- 5) **Beware the Carry Trade!** The key to the stability of China and India’s bull markets resides in the ultra low interest rates in *Japan*. Large hedge funds have borrowed hundreds of billions of Japanese Yen and re-invested aggressively around the world. Any increase in either the value of the Yen or Japanese interest rates could send *shock waves* thru the Emerging Markets if these opportunistic investors are forced to unwind positions quickly.
- 6) Please don’t lump us into the growing *camp of neo-isolationists*,

after just spending 3 weeks traveling through out India, I can verify the amount of construction and economic activity is mind boggling. There is no doubt that longer term China, India and Brazil will continue to have incredible economic growth. Right now it's simply a question of their stock markets getting too far ahead in a period of a potential financial crisis. We will continually look to re-enter these markets, but likely only after a 25% to 50% correction. View this as a tactical maneuver.

- 7) Also in December, we made a second significant tactical shift by **reducing our Domestic Equity** allocation to under 20% for most accounts. While we are normally reluctant to take profits in the last month of the year, the rapid deterioration in the global banking system argued to take profits while they were still on the table to take. Overall our domestic equities were up about 8 % for the year.
- 8) After this reduction, we are now at a **low allocation to the overall gravitational pull of the U.S. stock** market reflecting our concern of the stock market apparently shrugging off the huge crisis unfolding in the global banking and currency arenas. It is eerie how the stock market can blithely ignore a global financial crisis that has forced bank and brokerage firms to seek over \$100 billion in distress equity infusions in the past 60 days. But we need to be objective, if the storm hits with full fury, everyone will get wet.

- 9) The first two weeks of January seem to indicate the grave nature of the crisis is settling in, but **Washington's knee jerk "spend money" response** is disheartening, if not alarming. We repeat what we have been saying for the past 5 plus years : **It is a tragically flawed strategy to think America can spend it's way out of what is fundamentally a global supply / demand imbalance.** Spending more money at Wal-Mart will not fix what ails either the real estate market or the banking system. As my friend Scott Broom recently quipped, "Wal-Mart is America's land fill, because everything sold there will be in the dump within 18 months."



Monkey Business

- 10) You'll recall, back in September we made a tactical move to **reduce our exposure to financial services** by shifting from our long term holdings in small and mid-cap "value" stocks to large cap "growth" stocks. This turned out to be the right call as the financial sector has been hammered in the last quarter losing about 13% in the last 90 days of the year. By shifting our emphasis to large cap growth we were able to buffer, but not eliminate, this down turn. The Large Cap Growth sector

outperformed the Small and Mid Cap Value sectors by 3.3% and 5.6% respectively.

- 11) Even after the rash of *Shot Gun Weddings* in the Banking and Brokerage industry in the last 60 days, we still don't really think all the *bad news* is out yet. Our back of the envelope calculations seem to indicate that Citi, Merrill and a couple others still haven't fessed up entirely. *The day of reckoning will likely be between March and June. Expect even more capital to be pumped into the ailing Banks and brokerage firms.*



Catch a Wave in Esterillos Este

- 12) We'll have to admit we weren't perfect last year and our move into *Listed Private Equity* was the blemish on our record. However, we took our losses here to help offset the taxable gains from selling both the Emerging Market and Domestic Equities. We may revisit this position in several months, but the falling tide of all financial stocks was too strong to face here right now.
- 13) Do you recall our somewhat cynical position in 2006 when we predicted the modern day equivalent of an *Apollo Program for Alternative Energy*? Our idea was massive government spending would push up the stock prices of

the entire sector. In late December, Santa Claus came early with Bush's signing of the *Energy Independence and Security Act of 2007*. The result? Our *Alt Energy* stocks popped 10% the next day and ending the year up over 55% ! In most accounts, Alt Energy is about 5% to 7% .

- 14) While some might say Alt Energy will be the next stock market bubble, the grim *realities of our energy dependence* will continue to cause these shares to out perform their actual economic profits. Heck, we need to get past the next State of the Union address when the Energy Pork Barrel is announced. And what happens to these share prices if a terrorist event actually disrupts supplies? Or a Democrat gets elected?
- 15) Recently the energy minister of Saudi Arabia declared "*Nuclear is the Future*". We took notice and started building positions in Nuclear Energy sector. Our approach will be to use a basket of nuclear oriented companies to span uranium mining to manufacturers of nuclear facilities. Hype about "bio-mass" aside, massive investment in the *Nuclear Energy* looks to be the only proven way to bring the volume of energy onto the grid that can reduce OPEC dependence and meet the irreversible surge in demand. We'll start with 2.5% positions and may increase this longer term to 5% . We appreciate that this can be an emotional and/or philosophical third rail with some investors. If you have a strong philosophical

problem with this position, please let me know as we will remove this from your asset allocation.

16) **Long term energy prices are about supply and demand.** Globally demand is growing exponentially and there is no way to turn this back. This fall, the International Energy Agency issued a warning about “run away demand” and predicts China to be the world’s largest consumer by 2010. Let’s put this into perspective: *The global growth in demand since 2003 equals the entire output of Mexico and the North Sea!*

17) Having just returned from the motorized mayhem of driving in **India**, I can assure you that **demand in the emerging markets is growing exponentially.** Auto-rickshaws, motor bikes, cars and trucks cram the highways. It’s absolute insanity! Riding a Tuk-Tuk thru the streets of Mumbai makes the wildest terror inducing ride at Six Flags seem like riding the swans at Kiddie Land. From my simple observations, there is no way consumption is going anywhere but UP.

18) On the **supply side** of the equation, it’s a documented fact that production in 33 of the 48 largest producing countries is in decline. Ethanol is proving to be more hype than hope and will not be our salvation. Meanwhile, the major oil companies are cutting back exploration. Does anyone rally think supply of energy will increase faster than surging international demand ?

19) Now in a capitalist economy, how will this increasing demand and falling supply all get balanced out? Price!! This is why we’ve seen oil prices spike from \$60 a barrel to over \$100. This is a combination of at least 3 factors: a falling dollar, increasing demand and a premium for political risk. Do you see any of these factors changing? In the past 12 months, our positions in **Oil** (up 39%) and other conventional **Energy stocks** (up 35%) had super years.



The Emerging Market Tightrope or Through the Looking Glass

20) Due to rising **Resource Nationalism** around the world, the major oil companies are investing less in exploration because of the risk of nationalization. If they aren’t willing to invest in finding new reserves, who will? The current dividend payouts can actually be viewed as the companies self liquidating.

21) This isn’t just with Hugo Chavez and Venezuela. It’s much closer to home. Hillary has proposed taxing the “unfair” profits of exploitive

energy companies to put into some sort of government run energy fund. *Isn't that called socialism?*

- 22) We continue to think **Water** is one sector where we can weather the brewing storm. Our **Water Resources** investment returned over 16 % last year, helping to buffer our returns. Water is getting to be a bigger problem in both the Southeast and the Southwest with Atlanta, Phoenix and Las Vegas all putting a spot light on the problem. It is also one of the single biggest issues in global economic development as well. Most accounts are currently invested about 5% in this sector.



Can we take global capitalism for granted?

- 23) One direct result of globalism is that the demand for **food** will continue to increase as economies expand. While the world might not move from beans and rice to Big Macs, the per capita caloric consumption will increase as GDPs grow. This means more food and higher prices. To play this trend we have started to add an **agricultural commodity** component to our overall strategies. While also a

hedge against falling dollar, this is also a global growth theme without the politics and volatility of energy.

- 24) The **weakness of the Dollar** continues to be another major theme in our investment strategies with the Dollar ending 2007 down about 10% against the world's currencies. Over the past 5 years the dollar has lost 50% against the Euro. We will continue to hedge against this trend by holding commodities and other hard assets. Our positions in **Gold** performed very well last year with returns of 31%.

- 25) After 5 years of drifting, the Dollar is now at a **crisis point** which leaves the Fed little wiggle room to stimulate the flagging economy. If the Fed cuts rates at this point to stimulate the economy, the global currency markets might (should) respond *very* negatively. Recently both OPEC and China has issued none too subtle warnings here in the global press. Meanwhile, Wall Street is clamoring for up to 1.50% interest rates cuts. **This will be very negative for the dollar** and could stimulate a **nasty bout of inflation**.

- 26) **Mark our words here:** we are already in a **currency crisis** and with an election year, we lack leadership on this crucial topic. Look for the dollar to continue to slide until someone is able to grab the reins and halt the decent.

27) *Pleeeaaase!* Can someone explain to me (with a straight face) just how throwing more money (borrowed from China and OPEC) onto the consumption fire to buy trinkets at Wal-Mart (made in China) will help to revive either the real estate industry or fix the banking industry? The most recent election year grand standing about *stimulus packages* of \$800 per person is just an extension of this continued lunacy.

28) Letting the dollar slide now is a quick fix which will return to bite us in about 3 years when the impact of the lost purchasing power of the now *retiring Baby Boomers* comes front and center. At the height of the 2001/2002 stock market the Dow was at about 12,000, about the same as today. Yet over the same time the dollar has lost 40% of its global purchasing power. This means the average soon to be retiring Baby Boomer has lost 40% of his or her nest egg and doesn't even know it. Isn't this either a silent tax or an illegal expropriation? Every Boomer is now 5 years closer to retirement than at the peak of the last market. The "magic of compound interest" will not come to the rescue and there will be *a painful and potentially disruptive awakening in the near future.*

29) Every 6 seconds another Baby Boomer turns 65, and most of them don't have enough to retire on. *We'll say it again: What happens in a Democracy when "them's that didn't save" outnumber "them's that did save" and they vote?!* This

is tailor made for a populist politician preaching entitlement!

30) Uber-Guru of the bond markets, Bill Gross now says we're in the midst of the *worst bond market crisis since 1929*. While tempting, it's *still too early* to go bottom fishing for bonds. Wall Street is getting littered with the carcasses of hedge funds; Turks who thought they saw bottoms when bond prices were at \$0.90, then \$0.75, then \$0.50 now \$0.25. Down the road his type of turmoil can be favorable for the opportunistic buyer, but not now. In the mean time, start looking for garage sales in Greenwich Connecticut as the Masters of the Universe return to live with us mere mortals.

A final word, and allow me to vent. Call it "bonus envy." Every advisor we talk to these days says they were "long oil" and "short the dollar" last year. Count us as skeptics, but we doubt many actually parted from the herd. While many "talked the talk" of a Globalist style of investing, if they had actually "walked the walk", they should have had comparable results.

Barry Strudwick
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