

*The Proven Insights on Market Predictability*



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*Economic Report*

**FY2006**

**Q1-Q4**

## Economic Overview

*Due to the U.S. Treasury selling \$30 billion dollars worth of Treasury bonds 5 weeks ago (September 2005), there are \$30 billion dollars out of circulation--inducing a higher demand for US dollars. The result of this is not only alleviating inflationary pressures but eliminating them all together. Prices in gold and oil are beginning to fall. However, due to the Federal Reserve's decision to raise interest rates further, prices are falling at a slower rate than they would under "normal" conditions. Nevertheless, prices across the board are falling. This includes the cost of goods and services as well as commodities and real assets. What does this mean? This means the US dollar has become stronger--or its value has increased. Throughout the fourth quarter(Q4--October 2005-December 2005) through the first quarter(Q1--January 2006-March 2006) the stock market will rally somewhat because of the decrease in inflationary pressure. The only way to reverse this is to put more dollars in circulation--thus reinitiate inflation or to create an economic environment where the US dollars are no longer in high demand(i.e. raise taxes or implementing protectionist tariffs). Observing the Federal Reserve's habits for the past decade(1995-2005), this demand for dollars will increase unbridled until the economy enters into a deflationary period similar to what we had from 1999-2003. This will create a period where prices will fall to such a level that unemployment will increase due to the cost of wages falling where wage workers will no longer be in demand at their present price. Bankruptcies will increase due to the falling prices(nominally). The value of the US dollar will be of such strength that fallen prices will induce less "nominal" income for companies and individuals that they won't fulfill contractual*

*obligations (loans) to banks therefore defaulting on their loans. There will be reports of a housing "bubble". Prices will fall due to the increase in the value of and demand for the US dollar. Countries pegged to the US dollar will experience these effects at a faster rate and sooner than the United States. Hopefully, the Federal Reserve will decrease interest rates, but I doubt that will occur. Interest rates directly affect the rate in which the economy grows. They will believe that the raising of interest rates is the cause for stifling inflation, when the reality is the US Treasury taking dollars out of circulation resulted in the lessening of inflationary pressure. Unfortunately, I believe the Feds will continue to raise interest rates or cease at 4.75% (4 <sup>3</sup>/<sub>4</sub> quarter points).*

*This will result in an economic contraction. However, in any given situation there are winners and losers. It all depends on how one is positioned.*

# Future Performance of Well-Positioned Sectors during Q1-Q4 2006

## Debt Market

Bank Stocks: Banks will do well during Q2-Q4. Banks loan money when there are excess cash reserves. During Q2-Q4 there will be an increase of corporate and individual bankruptcies due to the increase in the value of the dollar and high interest rates. Banks will change gears and decrease loan distribution and invest more in low-risk value-oriented cash investment vehicles. Banks are by nature risk-adverse.

Money Market Funds: Money market funds will increase in value with unusually high interest due to the high Fed Fund rate. The interest rate of a money market fund will decrease as the value of the dollar increase, but at a slower pace.

Bond Market: Bonds will do well during Q2-Q4.

Revenue Bonds will be attractive and lucrative due to lower purchasing prices and higher payout (value-oriented) due to increased dollar value.

General Obligation Bonds will also be attractive due to natural disasters and rebuilding efforts throughout the country. The lower

*purchasing price will make these bonds a very good buy. Not only the increase of the bond-dollar value, but also the demand for these bonds will make this a lucrative investment.*

*Value-Oriented Bonds will become a very good investment for cash preservation due to the increase in the value of the dollar and the increased value of the bond.*

*Bond Mutual Funds will definitely become a great investment during Q2-Q4 especially with the diversification attribute of these funds.*

## *Energy Sector*

*Due to natural disasters and inflationary pressures, energy companies are raising prices while building stronger infrastructures in order to minimize the economic effects of these natural disasters. Although prices are rising in this sector, it is not immune to deflationary pressures. Energy stocks will be a strong buy during Q2-Q4, but if deflationary pressures are allowed to continue without being checked by monetary or fiscal policy, energy stock prices will fall also. The key to the energy sector's future success is this: Due to Hurricanes Katrina, Rita, and Wilma in the Gulf state areas, prices were raised in order to revitalize the Gulf States. Q1-Q2 is a period of frigidness and cold climate that requires an accelerated demand for energy. This factor inclusive with falling prices for goods and services due to deflationary pressure will make repairing the Gulf States' energy supply cheaper and permit faster expansion and distribution of energy to residents. The energy sector*

*will have a strong growth during this period(Q1-Q2).*

# Strategic Investment

## Stocks

*It is always good to learn from the past. During the deflationary period of 1999-2003 stock prices were dramatically low. This was a golden opportunity to increase wealth tremendously by buying good companies at strategically low prices. Of course, there was a tremendous sell-off. However, those who saw the golden opportunity to buy at this time are reaping tremendous benefits today. This opportunity has approached again. That is, if the Federal Reserve and Treasury continue to allow the US dollar to become an exceedingly potent currency. If this situation occurs, it will be in an investor's best interest to buy into good companies with low or manageable debt in strong sectors with competent management for the long-term.*

## Katrina and Rita Investing

*I wrote to my clients of my bi-weekly report who are mainly New Orleans-based, that we must invest in our city in order to come back home in an empowered position. I suggested that we buy into revenue bonds and general obligation bonds that will go into rebuilding toll bridges, levees, and sewage and waste management authorities. Also bonds that go into Real Estate Investment Trusts (REIT) and rebuilding buildings in New Orleans. The revenue*

*bonds will produce income for investors. Some of these bonds may be tax-free. To find out what bonds are being issued in order to reconstruct devastated cities in Louisiana due to Hurricanes Katrina and Rita go to:*

*[http://www.treasury.state.la.us/divisions/bondcommission/bondcommission\\_index.htm](http://www.treasury.state.la.us/divisions/bondcommission/bondcommission_index.htm)*

## *Real Estate*

*As we are now aware, prices are falling and the real estate sector is not immune. To those who benefited from the housing boom, this market will look unattractive during Q1-Q4. However, those who are patient and expect the boom to occur again, or those who desire to acquire land for agribusiness, investment property, etc. will benefit from this time. Prices will fall, and so will "property value". This is a golden opportunity to acquire real estate, or land, for future investments. As the "property value" goes down so will the "property tax" bracket. In fact, I suggest that prospective investors in land acquisition should wait until Q1 or Q2 2007 to buy the land and pay property tax early in order to secure the investment for the following year. Farmers or those in agribusiness should not only take advantage of this but also acquiring of major crop page(seeds, buds, etc.) and low cost of equipment during this time in order to expand production for future profits/growth. The best position to be in is to have major capital saved for this time to take advantage of this future period of low prices.*

# Employment Levels

*Employment levels will decrease significantly during Q2-Q4 2006 due to natural disasters and unbridled deflationary pressure. Deflationary pressure will drive prices down as well as the cost of goods and services. Businesses will no longer be able to afford labor at today's wage level(labor cost). Thus wage workers will either be downsized or will have to accept a reduction of pay. This also means that businesses and individuals will receive less income. Thus, it will be difficult to fulfill contractual obligations( i.e. loans). You will see a rise in corporate and individual bankruptcies. Corporations will begin to maintain a status quo and make cuts across the board to maintain their profit margins . This all will contribute to a significant increase in the unemployment level during Q2-Q4.*

# *Future's Outlook*

*As with all other markets, the futures and commodity markets will be affected by deflation. Prices will fall over the Q2-Q4 2006 period. Farm-based futures like soybeans, wheat, etc. should be bought during Q1 2006 in order to reap some reward during Q2-Q3. This period will not be good to buy gold or oil futures unless you wish to receive gold bullion in real terms.*