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"Positive Spin...What are the <u>benefits of a weaker dollar</u>? The weaker dollar may not be reviving inflation, but it is helping to reduce the risk of deflation. The weak dollar is good for U.S. corporate profits as earnings from abroad are higher when converted into dollars. The weaker dollar lowers the cost of commodities, especially crude oil, in countries with strong currencies, thus providing some stimulus to the global economy.

In my view, given my analysis above, the weaker dollar is not a problem for the stock market. It does create some opportunities. It tends to benefit the materials sector. It should continue to be a positive for metals and mining shares, especially gold and copper. It is also a positive for large U.S. multinational corporations." *27nov03*

Ed Yardeni
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Mr. Yardeni's views as stated above are realistic, valid and we think address the present.

<u>An update on our investment thought process:</u>

The protectionist sentiment and legislation, zealous terrorist hunting, Mutual-fund Industry's integrity woes, other ongoing high profile capital-market improprieties and imposed solutions can and do contribute to destabilizing stock markets. My unrealistic hope is that the USA will start reducing or dropping tariffs (Steel…), accelerate the exit from Iraq, make a serious effort to improve relations with Europe, remove the embargo on Cuba and… Although these are unlikely occurrences any time soon, these types of **bold** policy shifts are within the Administration's power to implement and are required, to constructively improve world affairs (our *lot in life*).

Negatives of a weak USD? The violent currency moves are destabilizing asset valuations worldwide, changing the economics of established trade routes and trade-partners, and stressing the store-of-value and reserve-currency attributes of the USD. "Foreigners who cannot vote in the USA, have been voting with their currency." Sounds like a beginning of a downward spiral, right? We don't think so and feel it is a loud call to action and change that will occur.

USA resilience, willingness, versatility and ability to evolve, are its strengths, as are the ideals that are espoused by the nation. If the Declaration of Independence and the US Constitution are the parents of the nation, then its progeny is change.

Motivational inputs that can contribute to decisive change:

- the short-term benefits of the weak USD to improve the economy
- approaching Presidential elections
- reality check on ballooning US deficits**
- new converts to the Anglo-American terrorist Crusade prompted by ongoing, *indiscriminate*, terrorist attacks
- creditor nations' vested interests in USD
- threatened reserve status of the USD
- need to curb protectionist sentiment
- growing mistrust of capital markets

Anticipated changes we foresee, are to the USA's best interest, and will reverse the current negative investment sentiment on the USD. We expect that the USD will appreciate smartly over the next few quarters, especially *vis-à-vis* the Euro, CAD, and Oceania currencies. Stock markets, however, often do not respond well to uncertainty, especially one prompted by imposed-changes, like the ones we are inferring.

China, decisions of and on China, are developing into a big wildcard. We do not know the sequence of evolving events that will develop in China, but whatever occurs, it will drastically change the world. This is no longer a closed economy, and will no longer be a silent Giant. You may have noticed that a previous economic-distraction has now developed into an ongoing pre-occupation of Governments, Labour, and Capital?

The Canadian dollar strength has increased the international-wealth of Canadians. Basically, Canadians can now purchase *more* goods and services internationally with the same dollar, than they could in recent years, especially those goods sourced from the USA. Our export market is negatively affected by the same currency moves. Corporate currency prompted decisions, capital and other resource shifts, are adjusting to the evolving currency-economics. For this reason, the Canadian labour market may remain less robust (e.g. cost for Canadian workers is up over 20% for an American company operating here).

Canadian Investor portfolio implications:

Diversification: Notably positive US Equity investment performance was negated in large part by violent and adverse currency moves (in sum, still positive however). US Fixed-Income investment performance was negative (Visavis clients held few US$ bonds and were less affected). Euro Fixed Income investments were positive. Euro equity investments improved.

Asset Allocation: For most portfolio-accounts, and where appropriate, we are considering to reduce Current-Equity investments by 20%(i.e. a portfolio with 40% in Equities to be reduced to 32% in stocks, but still within the equity allocation-range established). Why? Stock Markets have appreciated to levels where the price-risk of many stocks substantiates a small reduction in exposure. Also, anticipated 'changes' referred to previously, will probably spook the stock markets a little, in the short run. If lower valuations do materialize, we expect to then again redeploy these equity-earmarked-funds to opportunistically re-increase Equities towards your expressed target-equity preference. We think it is conservative to raise a small 'war-chest' at this time. If we are wrong and markets continue the welcomed **a**ppreciation, the stocks within your Equity allocation should also appreciate and we will again arrive at an Equity Allocation-level closer to your Target. The intention of this 'tinkering' (active management) is to reduce risk and we trust, to improve quality of returns; is not designed to maximized returns, but rather to provide a decent, risk adjusted return to conservative investment portfolios.

Your Fixed-Income investments, typically representing the largest proportion of your investment portfolio that we manage, are doing their part, are 'safe' and paying interest, albeit, not much to speak of. We expect that interest rates will continue to increase, and as we generally hold very short maturities, we hope that you will benefit further when we opportunistically invest your savings in higher yielding Government Bonds.

We welcome your views and input. As always, we are available to clarify any issues you would care to discuss or asset allocation modifications you wish to implement.

John Evdokias

(PS. Our, positive-spin? The rise in US interest rates that we expect is predicated on a sustainably stronger US economy. As this outlook becomes more apparent, the US dollar weakness will reverse rather drastically.)

** as measured by Kent Smetters and Jagadeesh Gokhale, closer to $44 Trillion rather that the $3.5 trillion that the government officially reports as its current level of debt held by the public. [Fiscal and Generational Imbalances, New Budget Measures for New Budget Priorities 2003]

This ten fold discrepancy arises because the authors correctly point out that the present-value of NET future liabilities for Medicare and Social Security (Entitlement programs not subject to same guarantee by Treasury as are direct obligations of the nation) are not included in the Total Debt figure. Headlines were carried internationally about the conclusions many drew from this report, ranging from the imminent default of USA because of these 'off-balance-sheet items, to discounting the methodology as impractical. We have reviewed the authors' paper, and from what we gather, their views are alarmingly and provocatively accurate. However, the assumptions on which their methodology and conclusions are founded are valid in the current interest rate environment, much as many public pension funds became 'unfunded' in part because of the cost of capital assumptions used (low interest rate imputation).

The Center for Economic and Policy Research(CEPR) comment on "The Forty-Four Trillion Dollar Deficit Scare" and make a good point that this unfathomable deficit-number if taken as a measure of GDP, can be distilled to a projected deficit of 6.5% of future GDP, "implying that a tax increase of 6.5% of GDP would be needed to close the gap." Although far from diminimus(small), it is manageable to deal with, we feel.

Bottom line, USA deficits are too large and need to be reduced. Market crashes, 9/11, Wars, homeland security, and a recent poor economy have not detracted from this need. Going forward, and in our interpretation, the Medicare system seems to be the area where expenses can be most expeditiously reduced. Alternatively, incremental taxes will creep in to pay for the desired entitlements.