Capital Drain

Rick's investment opinion newsletter February, 2006 v.2 no.1

Hi Readers,

No new name ideas here. School has been very busy. I'll graduate in June, and while I know I'll miss the social milieu, I think I've had enough of classes and homework for a while. We'll see if I can last longer than the summer before I start shopping for another graduate program. ;-)

OK, here we go. In my opinion:

Executive Summary:

I really don't have much to say.
By that I mean: it's pretty much like mid-January, when I last wrote.

The dollar is definitely conspicuously depreciating. The slide versus the Chinese Renmenbi (RMB) aka Yuan is now very steady, and slowly accellerating.

Inflation acceleration is now being taken seriously by many people, including most notably the Federal Reserve. At the producer level, inflation in the US is shockingly high. Consumer prices are being held down largely by everyday low low import prices and domestic producer reluctance to anger consumers with price increases that (hope springs infernal) may prove temporary.

Gold tumbled a fair distance from its highs, and is now climbing again. The tumble and renewed climb give me confidence it will continue upward.

The yield curve is still inverted, so the odds of a recession starting in six months are climbing steadily. The leading indicators are still falling and are now joined by slowly falling coincident indicators. That's starting to add up to something significant.

The Great American Housing Boom is slowing considerably, at least. It's too early to say it's actually going to bust (or even sag) but slowing is the first step toward sagging.

As before, I think everyone is best off with a **broad diversification** that includes at least **3/4 overseas** assets, reflecting the distribution of world economic activity.
These are **not the best of times**, so investors need to be in the best of securities: stick to value, to safety, to short maturities (for debt), and call me to chat if you're concerned about anything you're holding.

Above all, avoid the investments that are at all-time extreme valuations: junk bonds, developing-country bonds, and headline-grabbing stocks such as Google, Whole Foods, or Taser.
Sure, Google is doing great. So was Pets.com once upon a time. Google's a pretty good company, but at the current price you could only buy based on the Greater Fool Theory: "Sure, I paid too much, but I'll find a Greater Fool to whom I can sell it for even more!"

The Details:

The details are definitely as mentioned last time.

Re: the dollar, all major foreign economies are doing quite well, and their central banks either have raised or are talking about raising interest rates. That decreases the attractiveness of US interest rates, so some money that would have come here won't and some that is here may leave. Even currencies reflect the balance of supply and demand.

A curious possible additional demand shock for the Dollar is the new Mid-East Petroleum exchange where trading is denominated in Euros. Prior to this OPEC and Russia have proposed the idea, but it's been scuttled. If people don't need Dollars to get Oil, then they need a lot fewer dollars.

Gold is always tough to predict, and now is no exception. The bounce down from its recent highs gave lots of people a reason to think "What am I waiting for? I'll sell now." (I didn't, but I thought about it.) Now it's rising again, and I'm content to watch it rise. After the stumble, it's less scary to imagine buying more; the "if I buy it now it will stumble tomorrow" factor is much less.

The economic expansion rate, the Federal Reserve interest rate, and inflation rate are like three massive bodies in orbit around one another in space. Each definitely influences the other two. You may recall from your last physics class that it's relatively easy to describe the mutual orbits of two bodies, but not more. The Three Body Problem is as intractable for three suns in space as it is for three rates in the US. All you can do is look at the recent trend and say of each "it seems to be going *this* direction." Precisely when one will cause another to change direction is really really complicated.

This is the land of opportunity, so pick a Rate Scenario, put on your best suit, and go on CNBC to tell everyone you know the future. If you're wrong, no one will remember; if you're right, you can send out the interview as a DVD in your holday cards.

Housing prices are high relative to rents, incomes, historical appreciation trends, etc. Mortgage rates are rising. This may not be the start of the bust or even the end of the boom, but these are essential preconditions.

In the interest of timeliness over comprehensiveness,

It's time to hit "send."

If you have any questions, please please write or phone. If you want to read more, I've got a web site with old editions of this letter and some links to other interesting sites.

Please feel free to forward this to any friends or associates who may be interested.

For those of you getting this sample gratis, I charge $120/year for this newsletter. If you're not sure you like it, you could subscribe for 3 months for $40. Your checks, mailed to the address below, are always welcome, will be appreciated, and can be claimed as a tax deduction as an investment expense.

Take care,

Rick

Rick Drain
P.O. Box 5425
Redwood City CA 94063-0425

CapitalDrain @ Ricks-Cafe . net
http://www.ricks-cafe.net/CapitalDrain.html

"Our doubts are traitors,
And make us lose the good that we oft might win,
By fearing to attempt."
--W. Shakespeare