

Global

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July 31, 2006

*The Institutional Strategist*

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**Global Investment Policy**—Once per month in our global research book, we outline our global investment policy. But I thought it would be a good thing in view of recent events in the Mideast, recent Fed testimony and the clear call by China's leaders that they intend to slow the Chinese economy, that we review our recommended positions.

**Interest Rates**—Mr. Bernanke made a prescient call on the GDP number in his testimony last week, as the U.S. GDP figure on Friday came in precisely at his 2.5% estimate. That was enough to get the bond bulls running and we are now prepared to join them, at least for a trade in the short/intermediate area of the Treasury curve. We continue to think the central banks have commodities and the build up in inflation expectations squarely in their sights. This is a positive for bonds as the central bankers are correctly moving to head off inflation before it becomes a problem. Accordingly we are using 20% of the cash currently held in our global asset allocation model and are buying 3-year U.S. Treasuries at 4.94%. This reduces our cash holdings, all in Dollars, to 45%.

We elected to use Treasuries as opposed to European or Japanese bonds simply because of the yield advantage Treasuries have, our expectation that the Dollar will remain firm in near term and the need for the U.S. to halt both the bond market sell-off before it becomes too rapid (look at the channel chart of the Treasury) and what seems like a rapid slowdown in the housing market. According to the NAR (National Association of Realtors), national house price appreciation has slowed to just a 1% gain on a y-o-y basis through June and the Midwest region actually went negative. Housing remains the central asset price in the U.S. in our view, thus if the Fed is taking asset prices into consideration, the time is approaching when the Fed may want to move to protect the American consumer's huge investment in real estate.

**Equities**—We remain of the view that the big 3 equity regions and emerging markets are in a

## 10- Year Treasury Bond Yield



Courtesy of Bloomberg LP

## PPH—Pharma Holders—Breaking Out



Courtesy of Bloomberg LP

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transitional phase which will appear as a bear market in some sectors. The types of price recoveries we have seen in the indices over the past week are to be expected. The “black crosses” which occurred in Japan, Europe and the U.S. normally signal the beginning of a bear campaign, rather than the end of the bear, however we must also remember the central bankers may not be in favor of a bear phase at this juncture. An economic slowdown, yes, that I believe they favor if it slows the runaway in base metals and energy. But economic slowdowns produce slower earnings, so stocks are right to pause and it explains why consumer staples have performed so well over the past 3-4 months. We believe lower prices will appear, across the board, in the September-October time frame.

Regionally, we are overweight the U.S. and Canada and are very underweight Japan/Asia. Europe is a mild underweight while we have pretty much left the emerging markets. By theme/sector we still like parts of the energy complex, health care, utilities and large caps. We would underweight small caps, technology and consumer spending names.

**Currencies**—The U.S. Dollar should remain firm as events progress in the Mideast and a flight to quality unfolds.

We have no strong feeling on the emerging market currencies except to say that the Asian currencies look deeply undervalued and Russia's Ruble can go higher. Long run, we still think the U.S. Dollar can go much lower. Gold is our preferred monetary alternative to owning most other currencies, in the long term.

**Gold and Commodities**—We are out of the gold and base metals markets, in the belief the central banks will have their way and bring global growth to a lower level. In turn, this should be the catalyst for the first meaningful correction in the base metals bull market. Some of key base metals stocks appear to have put in double tops, a clear technical warning. The commodity of interest here is natural gas. Natural gas is a contrary play. We also like corn and wheat, due to

## 3-Year Treasury Yields—Back to 4.50%



Courtesy of Bloomberg LP

## OEX 100—Resistance Dead Ahead



Courtesy of Bloomberg LP

drought conditions. Wheat and corn producers are likely to enjoy the best prices for their crops in several years.

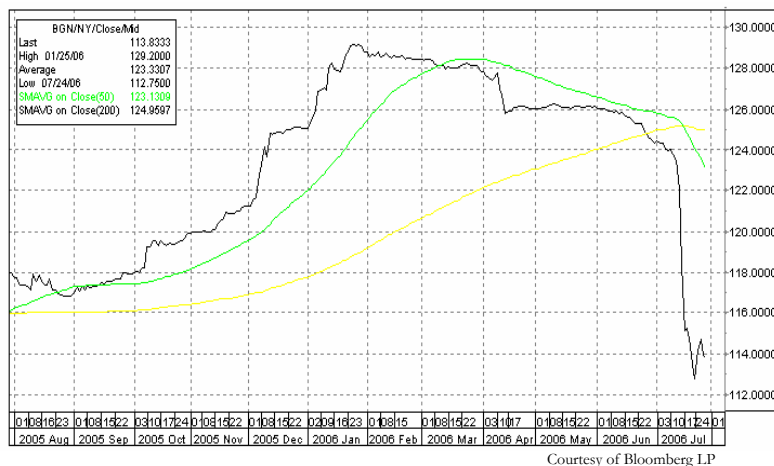
**Mideast**—After two weeks of intense fighting in Lebanon, there appears to be an acceleration of events underway. The thing we had not considered until this morning, was the possibility that the Israeli Defense force has been foxed. Hezbollah has had six years to dig into south Lebanon, they were the initiators, indeed the timing of this whole event appears to have been in their control. Is that why the IDF is no more than 2 km inside the Lebanese border and not more than that. It seems ludicrous for Israel's army to have come only that far up to this point, and then to suggest they would stop. That would do very little to insure Israel's future security, so it cannot be the ultimate objective.

The idea that Hezbollah has the IDF stymied is not an attractive one from the standpoint that the Israeli's cannot stop now. They must go on and root out the Hezbollah problem or suffer a daily rain of missiles upon its cities. That suggests the conflict runs longer than expected and if history is any guide, all sorts of unexpected actions might be taken by countries with an interest in the region. Israel has a record in the past, of innovation when attacked. They may haven been foxed once, but twice? I would not bet on that. Iran has an agenda. The Saudi's are beginning to re-arm, ergo they signed to purchase \$20 billion worth of French military hardware in just the past two weeks. The U.S. cannot be happy with that, but the signal from Riyadh is unmistakable. Then there are the proxies for the enemies of the U.S./Israel in the Mideast, Hamas and Hezbollah plus the dozens of splinter groups which operate in the region. Given a hint of Hezbollah's success in Lebanon and that is how it is being portrayed by Sheik Nasrallah, will they be emboldened to attack Israel on fronts other than Lebanon? Russia has a growing interest in the region. And then there is the oil card, which as you know, I believe will be played when Iran's proxies are on the verge of defeat.

### Lebanon 2-Year 10 1/8% Government Bond in USD due 08/08



### Lebanon 10-Yr Government Bond is USD 11 5/8% due 5/16



#### QUOTE OF THE DAY

**“We are not retreating—we are advancing in another direction.” ~ General Douglas MacArthur**

**We apologize for any delays and other problems you may have recently experienced in receiving your daily MIR. TIS has been undergoing a number of technology changes and our technicians are working out a few “bugs.”**