# THE WEALTH PRESERVER

**First Quarter, 2003**


*Stamper Capital Managed Bond Fund reached $1 billion on March 3, 2003!*

## Deflation
## - Confirming Evidence is in
## -The Last Holdouts Turn

Several times previously we have discussed the possibility of deflation occurring in the financial markets of the United States. In the 4th Quarter 2001 WEALTH PRESERVER article, "Deflation - The Unspoken Watch Word of the New Decade," we pointed out that commodity prices actually have been heading downward since November 1980. The article's Executive Summary **concluded that "deflation, not seen in the U.S. since the 1930's was highly likely to surface again..."** We also stated, "our down-cycle is most likely to be anything but a normal recession….we think it highly likely that the recession will turn into a depression and that deflation of financial assets will continue for some time."

In our 2nd Quarter 2002 WEALTH PRESERVER article, " 'W'hat the Economy Might Look Like," we stated that **the shape of the economic downturn would be a "W"** with "the slight economic rebound that took place from September 2001 not being a 'recovery' but simply a 'breather' in a much larger downtrend in economic activity."

In the 4th Quarter WEALTH PRESERVER article, "The Recession is Starting to Worsen - Asset Prices Could Gap Downward," we pointed out that "**At a certain time** during this downward economic cycle, we believe the public at large will reach **'A Point of Recognition'** when they realize the economy is not coming back for a long long time."

In our January (5th) 2003 January Market commentary (on our www.risk-adjusted.com website), after highlighting the mounting evidence of deflation:

- personal and corporate debt liquidation (across the board in most economic sectors)

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*Published March 24, 2003*

## It is Not The War [stupid] - It's the Business Cycle

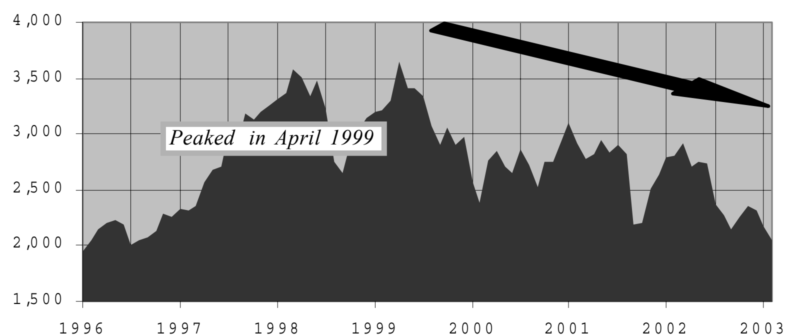
"It's the Economy Stupid," was the quote that George Herbert Walker Bush needed to hear to keep from losing his bid to be President of the United States for a second term.

**"It's <u>not</u> the War [stupid],"** is the quote we think needs to be trumpeted to the citizens, investors and media and economic commentators in the United States - better yet - **<u>"It's the Business Cycle."</u>** Despite what you hear incessantly from the media, we believe the economic downturn really has very little to do with the war - we believe it has totally to do with the mal-investments made especially during the late 1990's when people believed in the "new paradigm" which included hockey-stick forecasts of never ending productivity increases from new technology, principally computers and the internet. To us, the war is a confirmation of the economic downtrend in the business cycle (as was September 11th) - it is a symptom of the economic contraction.

In the mid to late 1990's false beliefs of absurdly high levels of new wealth caused peoples' allocation of resources to change, unfortunately in a non-sustainable manner.

Demand for more expensive luxury goods resulted in investment in plant and equipment to produce those goods. Best examples are high end automobiles and wine. Even as the economy has been in recession for two years, automobile companies are producing very expensive, high horse power automobiles, which shortly they will be unable to sell.

Another example that is a little further ahead of the curve is in **the wine industry**. On the Central Coast of California and in Northern California, acres upon acres of new grape vines were planted over the past seven years or so. Just recently, we have begun to see a collapse in the price of wine as those (supposedly) nouveau riche wine buyers/ collectors have discovered their long term wealth is dramatically less than they estimated in the late 1990's before the stock market began its downward trend. **In essence, their miscalculation caused them to consume their future.** The wine glut has pushed the prices of bottles of wine spiraling downward - i.e. "Two Buck Charlies" at Trader Joes.

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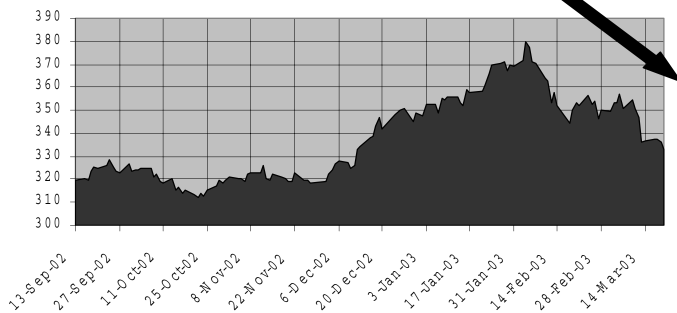


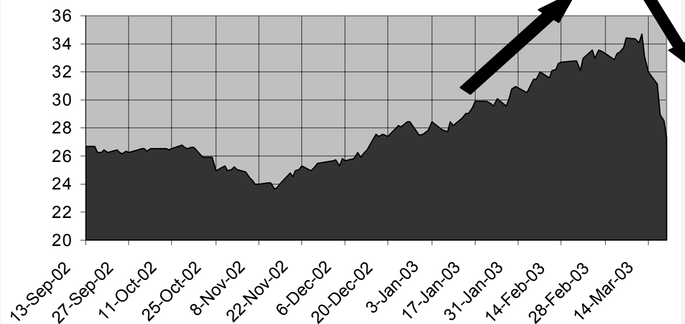


## *Deflation*

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- debt being liquidated (monetized at cents on the dollar - United Air, for example)
- faster than the money supply is increasing
- the burger war's - 50% cuts in the prices of hamburgers at McDonalds and Burger King
- demise of the recording industry (and the prices for its products)
- declining airline ticket prices
- worsening International Financial Markets(Japan, the Far East, Venezuela, Argentina and South America)
- rising commercial and residential vacancy rates
- the huge drop in consumer confidence statistics (decade year low)
- failures and underfundings of defined benefit pension plans
- broad, negative effects of rising State Budget Deficits

we concluded, **"We believe deflation is here now. We believe everyone else will come to that conclusion later in 2003."**

I believe that "Point of Recognition" (of the widespread existence of deflation and accompanying swift drops in asset prices) could now occur at any time - **The last holdouts obscuring this viewpoint from the majority (and, importantly, the media) were precious metals, oil (and gasoline), and real estate.** However, we believe prices of those "holdouts" have just now reversed and have joined the rest of the prices in a downward trend:

**Gold - Gold Futures have fallen 12%** from $379.90 on February 4, 2003 to $336.20 on March 19, 2003.

**Oil - Crude Oil Futures have fallen 21%** from $37.83 on March 12, 2003 to $29.88 on March 19, 2003. Prices at the pump should follow.

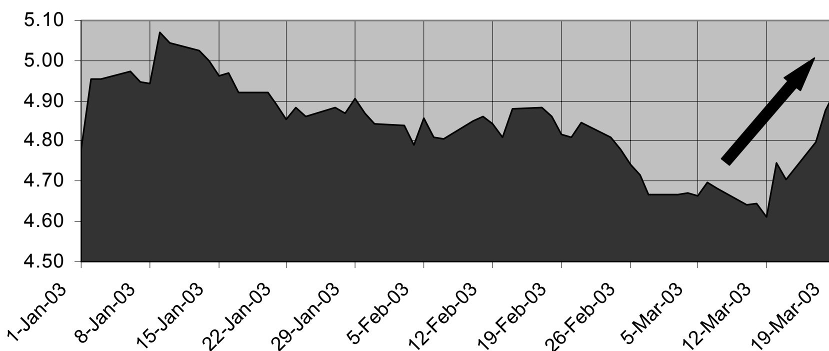
**Interest Rates** - Interest rates have **risen by 31 basis points** from 4.61% on March 12, 2003 to 4.92% on March 19, 2003 on the U.S government thirty year long bond. The Commodity Future on the U.S. Government Long Bond has **fallen by 3.6%** from 115-19 on March 12, 2003, to 111-12 on March 19, 2003.

Prices of **real estate** are strongly negatively correlated to interest rates. **Thus, if interest rates rise, real estate values will drop.**

**So, now the statistical evidence of deflation is no longer debatable - it is across the board in all sectors. It is just a matter of time before the media will begin reporting it.** As everyone comes to the same conclusion, "that deflation is here," asset prices will most likely experience huge historical drops as everyone pulls in their horns and heads for the exit at the same time.

Cementing our view even further, on Tuesday, March 18, 2003, in its Open Market Committee, **the Fed** said, "In light of the unusually large uncertainties clouding the geopolitical situation in the short run and their apparent effects on economic decision making, **the committee does not believe it can usefully characterize the current balance of risks [between inflation and recession]."** Obviously, quite a precarious situation - We at Stamper Capital believe it is recession/ depression for the many reasons we have cited.

Accordingly, because we believe widespread deflation is almost upon us, that the stock market is still grossly overvalued and that long term interest rates have begun rising, we believe the best place to be invested is in the highest quality, short term bonds and money markets, and in accounts at the strongest financial institutions (those with the strongest balance sheets).



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It will probably turn out that the what has happened in the wine industry is a very adept metaphor for our economy.

Another obvious metaphor for what has been happening to the economy to me is what has been happening in the **airline industry**. As you know, most of the airline industry's problems are blamed on the war. To this we again say, "It's not the War [stupid]; it's the Economy." First of all, the downturn in travel started well before September 11, 2001. It started down in May 1999 after the Dow Jones Transportation Average peaked. In Fact**, by September 10th, 2001, the Transports had already fallen by 27% from their April 1999 peak.** In addition, according to the National Bureau of Economic Research (NBER), the official business cycle dating committee, **the recession started in March of 2001. Thus, the travel industry and the airlines in particular were already suffering well before the War on Terror existed.** It had totally to do with the downturn in the business cycle.

The bottom line of all this mal-investment is resulted in a huge buildup in excess capacity for certain items. Basically, most of the people in the U.S. were living like royalty - spending their future in the present, most without realizing it. It manifested most outrageously in the fleeting area of entertainment: $9 movie prices, $18 compact disc's, $21 DVD's, $40 to $80 per month for cable or satellite television, $75 per seat tickets to professional sports and concert events (not to mention the outrageous professional sports' salaries), $20 bottles of wine, $50 per month cell phones, etc. **Current Consumption became America's obsessive hobby**. You might have seen it at CostCo or maybe on your coffee table - hundreds of catalogs of upscale consumer items (Its interesting that Spiegel, the famous catalog retailer including Spiegel, Newport News, and Eddie Bauer filed for bankruptcy on March 17, 2003).

This excess manufacturing capacity was financed, in part, with equity and, also, in a very large part with debt.Several times previously we have documented that debt levels of corporations are dramatically, by all measures, at the highest levels in at any time in history. Add to that record levels of personal debt taken on the pay for the ill-begotten consumption and to finance housing (or borrowed against housing), and record levels of local and state debt (the Federal debt should catch up soon). **So not only did the consumers miscalculate their wealth (and spend their futures) but the entrepreneur's and investor's and even more so (it will most likely turn out) the lender's also made a dramatic miscalculation.** Of course, most of the investor's and the ultimate lenders (banks and bond mutual funds lending their client's money) are actually also the consumers!!!

So "the people" borrowed up a storm to consume perishable goods in the present. In addition, most of the "investments" (more correctly speculations) they made were in the processes of making those perishable goods for sale at ridiculously high prices (can you say AOL Time Warner (with its recent $45 billion write down of its AOL investment) or some internet search engine).

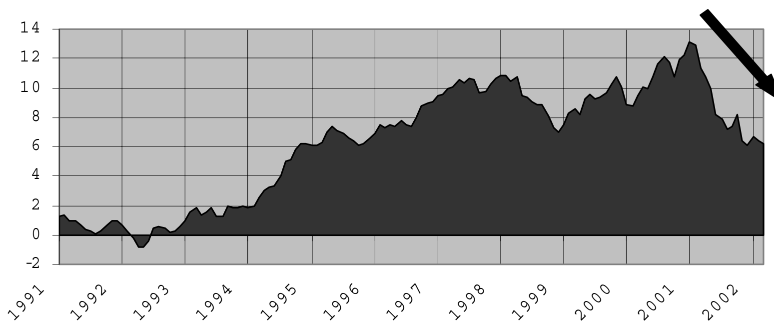
A "recession" is a decline in business activity when mal-investments and financing of the past is liquidated.

If the investments were grossly overvalued and financed with large percentages of debt, the liquidation results in a credit contraction.

If the credit contraction gets severe, debt begins to be liquidated. If debt begins to be liquidated, you run the risk of deflation.

If debt begins to be liquidated faster than the money supply is increased, you will have deflation and a long and/or steep depression.

## M3 Annual Rate of Change




Importantly, **the growth of broadest measure of the U.S. money supply, M3, has been slowing since November 2001** - this slowdown (see graph) is despite Mr. Greenspan cutting the discount rate 11 times starting beginning January 2001 (from 6% down to 0.83% currently).

Unfortunately, the "new paradigm" mal-investment has been so huge (as evidenced by the most historic overvaluation of the stock market in history based on all measures), and the nature of the investments was so poor, and the debt levels that financed the bubble so unsustainable that we have for some time been forecasting a dramatic credit contraction and accompanying depression.

Now that the final evidence has arrived, we believe the public will be at that "point of recognition" at anytime and their mass movements will create a dramatic downdraft in asset prices.

### *Job Furlough's in addition to Layoffs indicate Deflation*

*On the periphery of the political/financial press coverage, we have recently been reading that several State and Local Governments are trying to use work furloughs, some forced and some voluntary, to lower expenditures in order to balance their budgets. Generally, the furloughs suggested are leave, or even work, without pay for one day to a few weeks per year. Most recently, on March 21, 2003, California Governor, Gray Davis, made the furlough appeal to union members suggesting the alternative is a layoff of three percent of the work force they represent. We have seen similar approaches in Boston, Houston, and the State of Utah. California Department of Personnel Administration Director, Marty Morgenstern said, "**There are tradeoffs possible like that: Instead of one person taking the whole burden, maybe several could take it."** Sounds like an across-the-board stealth pay cut in a DEFLATIONARY economy to us.*

# Our Fund Performance

Stamper Capital & Investments, Inc. has managed the Evergreen High Income Municipal Bond Fund since June 1990. The $1 billion fund has been repeatedly recognized by Morningstar as a top-performer among its class, with the highest ratings in the overall and three-year periods. Stamper Capital & Investments, Inc. is a Registered Investment Adviser that specializes in the municipal bond market and is dedicated to helping investors earn the maximum return per the amount of risk taken. **Check out our website at www.risk-adjusted.com to find out more about how our strategies can reduce your overall portfolio risk, while maintaining equity-sized returns!**

## Short-Term Municipal Bond Fund Category, Morningstar Rankings

| Period As of 2-28-03 | E.H.I.M.B.F.* Rank | Number of Competitors | Category Average Total Return | E.H.I.M.B.F. Tax-Free Total Returns | Pre-Tax Equivalent Total Return[1] | Morningstar Ratings[2] (5 stars possible) | Percentage Ranking |
|---|---|---|---|---|---|---|---|
| 1 Year | **59** | 102 | 4.59% | 4.37% | 7.12% | | |
| 3 Years | **11** | 92 | 5.43% | 6.43% | 10.47% | ★★★★★ | Top 10% |
| 5 Years | **45** | 84 | 4.24% | 4.35% | 6.91% | ★★★★★ | Top 10% |
| 10 Years** | **14** | 34 | 4.50% | 4.59% | 7.48% | ★★★★ | Top 32.5% |
| Overall | **-** | - | - | - | - | ★★★★★ | Top 10% |

*E.H.I.M.B.F. = Evergreen High Income Municipal Bond Fund, subadvised by Stamper Capital & Investments, Inc.

** Results from the B shares. A share estimate: 4.59 + .75 basis points = 5.34% or 8.70% pre-tax equivalent

The above chart summarizes the performance of our mutual fund client. We also offer Private Account Management with different strategies and greater opportunities to earn higher yields. **To give you an idea of the types of strategies available and the potentials offered through our Private Account Management, be sure to check out our website at: www.risk-adjusted.com.**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Disclaimer: Prior Performance achievements are not necessarily an indication of future performance. In other words, past performance does not guarantee future results. There are many types of risks and returns, and the trade-offs among them can result in different positive or negative returns depending upon the subtleties of the specific credit and security characteristics.

1. The pre-tax equivalent total returns are figured based on the highest Federal income tax bracket of 38.6%, no state taxes were included in the calculation.

2. Morningstar's proprietary ratings reflect historical risk-adjusted performance within a narrow investment category. Morningstar calculates a Morningstar Rating based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly performance, including the effects of sales charges, loads and redemption fees, placing more emphasis on downward variations and rewarding consistent performance. The ratings are subject to change every month. Morningstar ratings are calculated from the fund's three-, five- and ten- year (or life of fund, which ever is shorter) average annual returns in excess of 90-day U.S. Treasury Bill returns (on a monthly basis) with appropriate fee and tax adjustments and a risk factor that reflects the fund performance below 90-day T-bill returns (on a monthly basis). The top 10% of the funds in each category receive the highest a rating of five stars. The next 22.5% receive four stars, the next 35% receive three stars, the next 22.5% receive two stars, and the final 10% receive one star. Each share class is counted as a fraction of one fund within this scale and rated separately, which may cause slight variations in the distribution percentages.