THE WEALTH PRESERVER

Third Quarter, 2003

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Bye Bye to the 22 Year Old <u>Bond</u> Bull Market

(not due to an improving economy)

The twenty two year Bond bull market, which began when interest rates peaked in September 1981 most likely ended June 13, 2003. Since then **interest rates of all maturities longer than six months have risen dramatically:**

US Gov't	6/13/03	8/3/03	Rate Rise (points)	% Capital Loss
30 Year	4.17%	5.33%	1.16%	-16.0%
10 Year	3.11%	4.39%	1.28%	-9.9%
5 Year	2.03%	3.23%	1.20%	-5.2%
2 Year	1.08%	1.80%	0.72%	-1.4%
6 Months	0.84%	1.01%	0.17%	
Stamper Managed Mutual Fund, Y Shares=>				-0.4%

Our Money Was Where Our Mouth Was - You can see from the above chart that the Mutual Fund we sub-advise performed incredibly well during this most hostile period. Official figures will be out shortly and we expect to be one of the top performers. Our Private Account performance will likely show a positive return.

This was **The Fastest One Month Rate Rise Since 1987** - Yes, and we all know what happened later in 1987, a 36% stock market crash from August to October.

Supply Supply Supply (not recovery recovery recovery): In a few ways the bond market is very similar to the Real Estate market. One way is that there are just a few main drivers of these asset classes with supply and demand being the ultimate. In the case of this bond crash, counter to the mainstream media, **we believe it is the supply of new debt coming to market rather than demand from borrowers investing in the recovery.** We were/are looking for record supply of new debt from individuals, municipalities including cities and states, corporations, and The U.S. Government (see "Interest Rates Can Rise in Recession," 2nd Quarter 2002 THE WEALTH PRESERVER.) In fact, in the last week of July, the Federal Government announced that it would sell a record $60 Billion of new securities, this to finance the record new

Continued on the inside back cover...

The Depression Starts - UGH!

The recent case for "the recovery" (as presented by the media who totally missed the top of the equity market and the economy and have consistently miss-called the bottom of both) is based primarily on the **recently rallying stock market** and recently increased rate of **growth of the Gross Domestic Product**. Below I analyze and dissect those two media "positives" and then discuss numerous negatives.

Typical Bear Market Rallies - As we stated previously, the current stock market rebound of 28% to the month-and-a-half-ago peak (June 17,2003) is at a typical percentage increase for a counter-trend rally in a bear market of this size. In fact in the 1930's depression, the market rebounded almost 50% from around 200 to just under 300 before resuming its drop to the eventual bottom at 41, a loss of 89%!!!! (and that was for the index which does not include the values of the stocks that were delisted during the period.) The huge drop started from the market top of 380.33 on August 30, 1929.

Gross Domestic Product - The financial media has been touting the recent 2.4% GDP annual rate for the second quarter of 2003. This level is an increase from the 1.4% annual rate of growth for the first quarter of 2003. While it would be great if we could take the recent quarterly number at face value, there are a few caveats that the press has not talked about. First, economists largely agree that, in order to create jobs, the economy needs to grow at over 3%. But that is not the worst part. **Defense spending, contributed around 75% of the 2.4% growth rate; 44% of that defense spending was war-related.Thus, without that unusual defense spending, GDP grew at only 1.6% for the quarter.**Looking into the future, below I have listed all sorts of anti-stimulus, GDP decreasing events that are, unfortunately, just now starting to occur.

State and Local Government Budget Deficits and Decreased Spending - Spending by cash-strapped state and local governments, unfortunately one of the largest sectors of the economy declined 1.5% during the second quarter of 2003. We believe that reduction is only the start. For example, California has finally "balanced" its budget (33 days late); as we expected, it contains $1.1 billion in savings from state workers that will be taken either through layoffs or by deferring salary increases, including the abolishment of 16,000 permanent positions. In addition, to that decrease and decreased services and increased fees, the budget is "balanced" by $12 billion in additional borrowing and, according to analysts, is forecast to create a budget deficit for next year of $8 billion. In reaction to all of this, the State of California's credit rating was downgraded three notches to BBB, one notch above junk status, just a few weeks ago. Importantly, many of the budget measures from the State "rob Peter to pay Paul" by decreasing State payments to cities and other municipalities. Similar situations exist in almost all State, County, City, and local municipalities across the country.

Company's are still failing and downsizing - Mirant Corporation ("MIRKQ"-OTC) just two weeks ago became the 11th largest company to file for bankruptcy protection in United States history. It has $19 billion in book asset value. The Company provides electricity and

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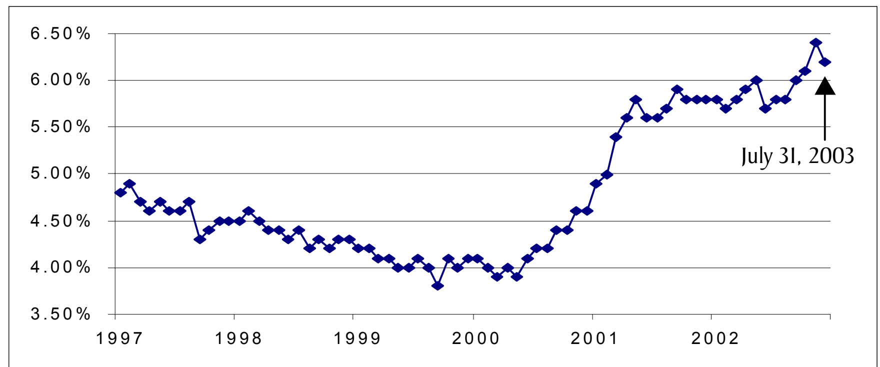
energy-related products and services throughout the world and has 7,000 employees. By looking at the number of companies whose accountants will not give them "going concern" audit opinions, numerous other companies are on the verge of filing. Layoffs are continuing. **Boeing** ("BA"-NYSE) has announced that it plans to shed another 4,000 to 5,000 jobs by the end of the year. **May Department Stores** ("MAY"-NYSE), the second largest department store company in the U.S., has announced it will shut 32 Lord & Taylor stores and lay off 3,700 employees. On July 30th, **Pillowtex Corp** ("PWTX"-OTC), a large manufacturer of home textile furnishings for the bedroom and bathroom, announced its intention to file bankruptcy, closed its 16 textile manufacturing and distribution facilities and announced it will be terminating approximately 6,450 salaried and hourly positions. Its brands include Cannon, Fieldcrest, and Charisma, among others. Corporations have been slashing wages and benefits. For example, employees at **American Airlines** ("AMR"-NYSE) recently agreed to a 23% cut in pay and benefits to just barely avert bankruptcy.

Unemployment, A Real Tragedy - The statistics present somewhat of a mixed bag if you look only at the last month's statistical changes (as the major media reports it); however, if you take a more realistic look the numbers are very depressing. The official "unemployment rate" dipped to 6.2% from June's 6.4% (a nine year high); however, the figure takes those who are so discouraged as to quit looking for work out of both the numerator and denominator - so the improvement is illusory. Also, the bulk of the improvement was in part-time jobs. As for the actual job count (which is deemed more reliable because it is determined using a much larger survey), the economy has lost jobs for six straight months including a loss of 44,000 jobs for the most recent month. Over one million jobs have been lost since the recession officially ended November 2001. Also, Unemployment claims hit a nine-year high of 6.4% in June and have consistently remained above 400,000.

Rising Rate Effects: The recent sell off in the bond market is going to worsen several anti-stimulus factors. In short, with interest rates rising across the board, applied on record debt balances, in order to just keep everything "even," other costs must drop - this all adds up to DEFLATION. For example, a house payment on $150,000 thirty year mortgage at 5.28% (the bottom in rates just under two months ago) would be $831 (principal and interest). But now the thirty year mortgage rate has gapped up to 6.26%. Keeping the monthly payment the same (and using the new higher mortgage rate) would lower the loan amount to $134,836, or a drop of 10%. Thus, if interest rates go up, in order to keep the monthly payment the same, the value of the asset must drop. **We believe rising rates will ultimately cause (more correctly expose) the deflation that was hidden when interest rates were falling.**

U.S Unemployment Rate Still Very High



Dramatically Declining Mortgage Applications - After the recent dramatic interest rate rise, the Mortage Bankers Association (MBA) announced it weekly measure of mortgage loan applications for purchases and refinancings decreased by 24.3% compared to the previous week (and was down 2.4% from the corresponding week from the corresponding week from the previous year). However, it must be pointed out that most of the drop was for refinance applications which are down 50% from a couple of weeks ago. Purchase applications have shown only a modest drop and are still near all time highs. Still, the housing bubble was driven by lower interest rates and the mortgage refinancing boom. Thus, we believe this downturn in applications in conjunction with rising interest rates and the drop in consumer confidence, etc. **signals that the top of the real estate market has passed.** Because most people refinancing their houses put as much debt on their property as they could, the combination of higher rates and record debt levels (low homeowner equity levels) will almost certainly lead to massive housing defaults which will drive the values of houses not only down, but down below any sense of "fair value." Therefore, we must say "**Adios to the Real Estate Market - Housing Has Topped**."

Consumer Confidence - took an "unexpected" dive in July, falling from 83.5 in June to 76.6 in July, or a 10% drop (analysts had incorrectly forecast a consensus 1.5% point increase).

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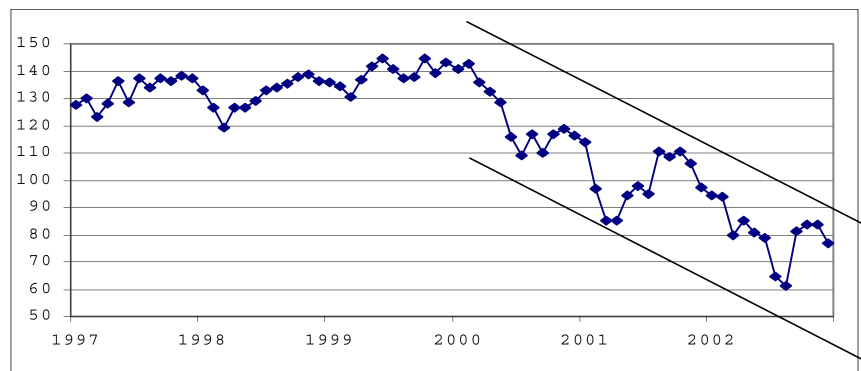
Consumer Confidence Index-Trend Still Down



Doesn't Feel Much Like a Recovery, Does It?

You probably did not hear about it but in late July, the Cycle Dating Committee of the National Bureau of Economic Research (NBER) announced that **the latest recession officially ended in November 2001.** The group waited 20 months after the fact to call the end to the contraction because **almost one million jobs have been lost from payrolls since that time.** I guess the old joke that if your neighbor lost his job it is "a recession;" if you lost your job, it is "a depression" is not quite correct - if GDP is up it is still officially "a recovery."

In the 2nd Quarter 2002 THE WEALTH PRESERVER article "'W'hat the Economy might look like" we detailed that we thought the economic downturn could take the shape of a right-tilted "W" with "the bottom of the left tip of the "W" being around September 2001 and with March 2002 being the middle peak of the "W." We still hold that view. Importantly, the peak in the Dow Jones Industrial Average in March 2002 (our middle peak) was 10,635 or 14% higher than the most recent peak on June 17, 2003 at 9,323. Thus, given we expect stock prices and the economy to decline precipitously from right now, we would not be surprised if a new recession is declared with March 2002 as its inception.

As previously, "the main point of [that and] this discussion is that the slight economic rebound that took place from September 2001 to now was not [really] a recovery but simply a "breather" in a much larger downtrend in economic activity. Accordingly, we are still recommending [and we are again now recommending] investors brace for the worst, which we expect to begin shortly."

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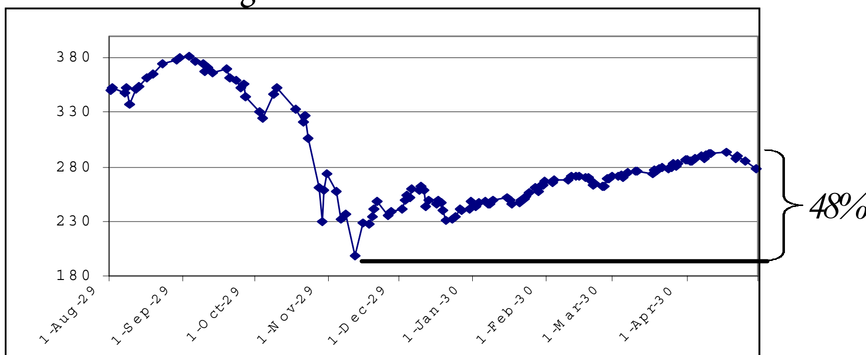
Given the factors we have listed above, it is easy to see why consumer confidence is falling. The real story is that the psychology of the bear market is still here.

Consumer spending contributes about 70% of GDP and was up 3.3% for the current quarter. However, given the recent decline in Consumer Confidence, accompanied with cost-increasing rising interest rates applied on record debt levels, it is an easy forecast that consumer spending is now dropping and will cause a negative growth rate for the economy.

Equity Markets - Downtrends still Intact & Massive Overvaluations Still Exist -The equity market is still grossly overvalued by all reasonable valuation measures. Our forecast in the January 2001 MONTHLY MISER article, "Money Magazine Predicts Dow Jones Plunge" where we used MONEY MAGAZINE's statistics to calculate what we believe to be fair value on the Dow Industrials of 3,110 based on dividends, 6,173 based on net profits (which have fallen since then) and to calculate market bottom levels of 1,555 based on dividends and 3,086 based on net profits, both of the 1974 market bottom. We still stand by those numbers. In addition, all indices are dramatically below their March 2000 highs and even below the recent mid-June 2003 highs; therefore, the trend in equities is still down.

Our Conclusion - Despite all the hoopla from the financial and mainstream media over the recovering economy, it is quite clear to us that the economy, unfortunately, is continuing its slowdown. We believe shortly, unfortunately, it will begin to pick up downward momentum, and, feeding on itself, will accelerate like an avalanche in an economic downturn that will be called "the depression."

Dow Jones Industrial Average 48% Rebound during Middle of 1929-30 Stock Crash



Bond Bull Market

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deficits due to the tax cut, the war, and declining tax receipts (the last reason similar to what California is going through). Remember just a couple of years ago they were forecasting a huge budget surplus and now they are forecasting a huge deficit which will be funded by newly issued debt.

The Fed Doesn't Really Control Interest Rates - if it did, it would not have let them rise so dramatically. We believe that while the Fed can control interest rates to a point, but, in the long run, their actions are completely dwarfed by the actions of the market participants; thus, the Fed is a follower rather than a leader over the long term. **Right now they are a follower.** In last quarter's THE WEALTH PRESERVER we questioned "Does the Fed's Policy Really Work?" and concluded that "the Fed's policy for creating liquidity and growth 'work' in a bull market when people are optimistic and fail in a bear market when people are pessimistic…All the Fed does is exacerbate the natural economic cycles." **Right now, we believe we are in a cycle of pessimism.**

Forecast - We believe that the 22 year bull market in bonds is over and that interest rates will continue to rise in a stair step fashion. Accordingly, we continue to recommend only shorter maturity bonds. We also believe that "the recovery" will be re-labeled back to a recession led by a dramatically dropping stock market which should commence soon, if not immediately. Accordingly, we continue to recommend only the highest quality bonds. As in our previous forecasts, we continue to believe SAFETY is the watchword for this decade.

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 7-31-03	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	**33**	94	2.27%	2.62%	4.03%		
3 Years	**18**	82	4.58%	4.58%	8.00%	★★★★	Top 32.5%
5 Years	**37**	72	3.96%	3.96%	6.12%	★★★★★	Top 10%
10 Years **	**13**	28	4.32%	4.36%	6.71%	★★★★	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: 4.36 + 75 basis points = 5.11% or 7.86% 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 35%, 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.