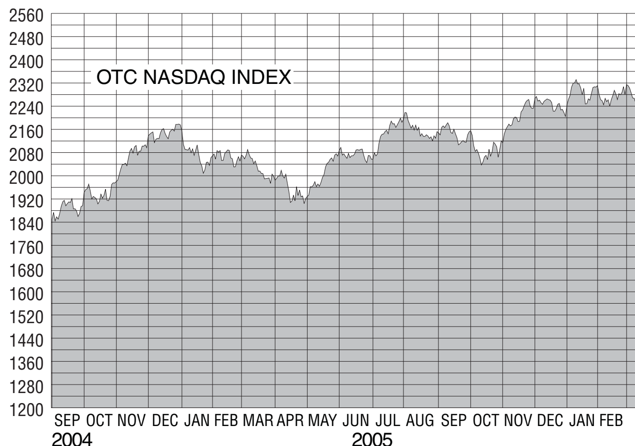
InvesTech® Research

Market Analyst

Vol06 Iss04 — Technical and Monetary Investment Analysis — MARCH 17, 2006



4 Weeks Ending March 10, 2006

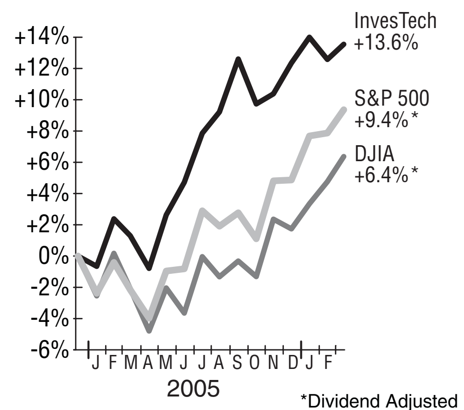
	High	Low	Last
Federal Funds	4.88%	4.45%	4.50%
30yr T-Bonds	4.75%	4.48%	4.75%
Gold (London PM)	$565.25	$535.00	$535.00

	High	Low	Last	200D M.A.
DJIA	11137.17	10892.32	11076.34	10654.80
DJUA	416.55	397.75	399.93	401.40
NASDAQ	2314.64	2239.81	2262.04	2180.99
S&P 500	1294.12	1262.86	1281.58	1236.37

S&P 500 P/E Current: 18.4 70 yr Avg: 15.6

A 271-TRILLION POUND GORILLA

Wrapping up the first quarter, we can't say our single-digit gains are spectacular. In fact, our more defensive cash position allowed market indexes to close the gap slightly with our out-performance of the past 15 months. ⟶



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But sounding like a broken record: *"This is not the time for home runs or spectacular plays."* If the bull market provides more profit opportunity this year, as our indicators suggest it might, then we intend to take advantage of them. However, we are concerned that weather conditions could quickly turn stormy for investors, and that systemic risks will play a key role in the storm's intensity.

Systemic risks are those that can create havoc outside the normal economic cycle. They go beyond the 1-sigma or 2-sigma probability of occurrence that is built into the Fed's economic models. The housing bubble is one such systemic risk today… and as you'll note inside, our Housing Bubble Bellwether Index has suddenly broken a key support level.

Another systemic risk lies in the derivatives market. These are leveraged investments –from options to futures to credit swaps and guarantees– which have been created to hedge risk by the big market players. Today, the nominal value of global derivatives totals over $271,000,000,000,000… that's $271-**T**rillion with a capital "**T**". These didn't even exist during the interest rate volatility of the 1970s. And by comparison, they now total 160-times the $1.7 trillion on Black Monday in 1987 – what we would call the last 3+ sigma event.

Inside this issue, we update our major technical models and discuss how to protect your portfolio against this 271-trillion pound Gorilla if it breaks loose and starts to go on the rampage.

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UNCHARTED WATERS

"A Safety-First Strategy for Systemic Risks"

Wall Street's bubble of the late '90s seemed unprecedented enough. Then came the big bear that cratered the Nasdaq Index to a 78% loss, immediately followed by the most aggressive easing in Federal Reserve history. And today an unprecedented Housing Bubble has been created. One that has clearly peaked – *even acknowledged by the National Association of Realtors this month (see my Personal Perspective on page 7).* And one can only guess at the course of the eventual unwinding.

This creates a unique, if not unpredictable, monetary climate.

From generational lows in 2003, interest rates have been raised 14 consecutive times by the Federal Reserve. One subscriber called to ask for an update of the table shown here [from our August 19, 2005 issue]: →

S&P 500 Gain/Loss
After 2.50% Total Discount Rate Hikes
1920-2005

	3mo Later	6mo Later	12mo Later
Aug. 1929	-25.4%	-18.4%	-28.6%
July 1973	5.2	-5.2	-18.1
Aug. 1978	-8.3	-4.3	4.8
Dec. 1980	-4.8	-3.1	-7.5
June 2005	?	?	?

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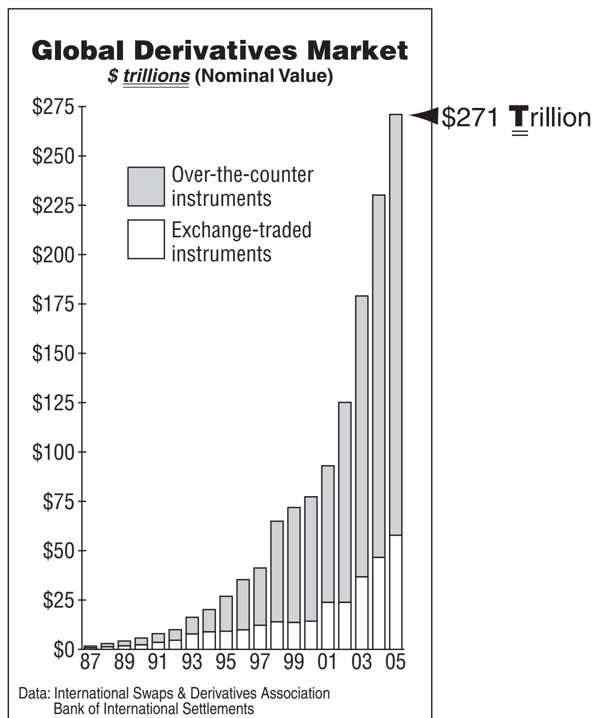
If the Federal Reserve increases interest rates again (as anticipated) on March 28, that will mean short-term rates have risen 3.75% from their lows. We don't need a table to display the market's response… as there were only two such instances in the Federal Reserve's 93-year history: 1978 and 1981. These were volatile periods for both the economy and interest rates. Both saw small, single-digit changes in the S&P 500 Index over the next 3, 6, and 12 months, which doesn't seem very ominous for investors. However, stocks were at ultra-cheap valuation (P/E) levels in 1978 and 1981, which is not the case today.

In addition, both 1978 and 1981 saw interest rates continue to rise, and both ended in recession – 14 months later in the first instance, and only 2 months later in the second.

That gives us very few precedents for today's interest rate environment.



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← Unfortunately, it also leaves us worrying about that 271-trillion pound Gorilla mentioned on page 1: the global derivatives market. The growth in these highly-leveraged financial instruments and transactions is truly mind-boggling.

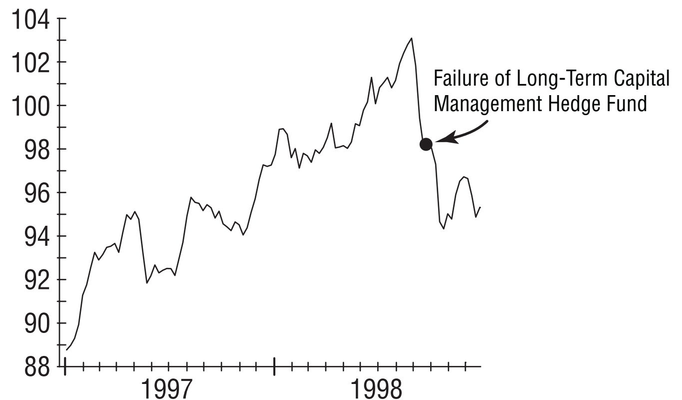
Having doubled in just the past 3 years, the nominal (or face) value of derivatives is now 160-times greater than in 1987 when volatility in the currency markets and interest rates helped trigger the crash known as Black Monday. At the time, the media blamed that 23% one-day loss on program trading. Key question: *How much worse would the 1987 Crash have been if derivatives were at today's level?*

And the more important question:
How do we protect our portfolios from this Gorilla if it gets unleashed?

That requires a 3-part strategy. And while we don't talk about it much, subscribers (and SFM clients) need to know this exit strategy is always in the back of our minds:

1) **Watch for a sharp, unexpected move in either the dollar or 10-year Treasury yield.** In other words, don't watch the derivatives cart. Instead, watch the bumps in the road that could derail or upset the cart. That means watching the dollar and long-term bond yields for sudden, unexpected changes – especially *unfavorable* changes. It required only a 5% plunge in the dollar over 3 weeks to cause the failure of Long-Term Capital Management, an over-leveraged derivative hedge fund, in 1998. ⟶

   That event brought an overnight crisis intervention by the Federal Reserve, and could have triggered panic on Wall Street if it had occurred on a broader scale.



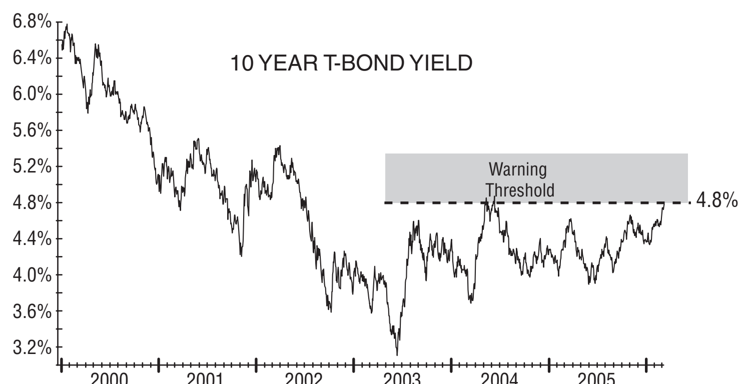
2) **Avoid investing in the major derivatives players when the dollar starts falling or interest rates are rising.** In 1987, only 7 major banking and securities firms comprised 2/3's of U.S. derivative usage. According to the International Swaps and Derivatives Association, these firms had between \$3-\$6 in derivative risk for every \$1 in stockholder equity: Morgan Stanley, Goldman Sachs, Chase Manhattan, Merrill Lynch, Bankers Trust, Lehman Brothers, and JP Morgan. That exposure is undoubtedly <u>much higher</u> today. For the most part, these companies are reporting record earnings, but you couldn't drag us into them in the current deteriorating climate.

3) **Have a fail-safe exit strategy.** In reality, no exit strategy can be 100% fail-safe. But certain technical models can turn very quickly and forcefully to compel you to make the right move at the proper time. Our Negative Leadership Composite is one such model. Over a one-month period in July 1998, our NLC plummeted from 0 to -100 –*its maximum bearish reading*– a full 7 weeks before the Long-Term Capital Management debacle hit the headlines and triggered Federal Reserve intervention on September 23.

So bottom line, we don't want you to lose sleep worrying about derivatives and systemic risks. But you need to be aware of them, just as we are. While you need to make sure your own portfolio is devoid of the high-risk stocks, we'll do our part to keep you informed of the above warning flags if or when they appear.

TECHNICAL UPDATE

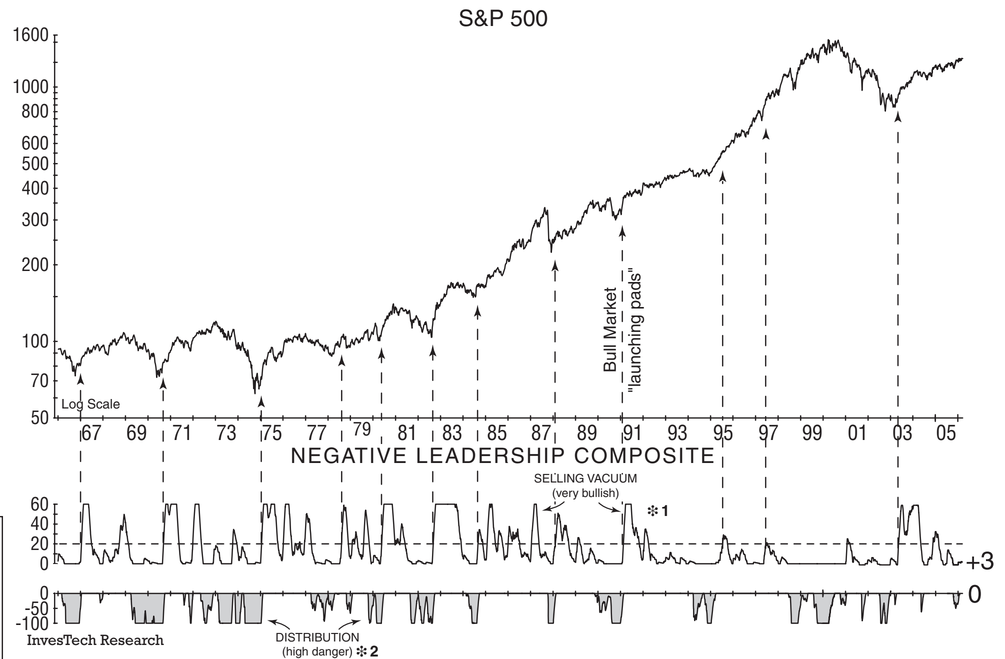
Since our last issue, the 10-year T-bond yield (@ 4.7%) has flirted with our 4.8% Warning Threshold. Keep in mind, there's nothing magical about the 4.8 level. Yet if broken, the danger is that substantial new highs could follow in long-term interest rates. And while the bull market has weathered 14 rate hikes by the Fed, and might survive a 15th later this month, we believe any significant upturn in <u>longer</u>-term rates will sound the death knell for the bull. ⟶



Leadership

Our Negative Leadership Composite is hovering near 0... both in terms of a bullish SELLING VACUUM [*1], and a bearish DISTRIBUTION [*2 -shaded region]. This doesn't suggest a major move in either direction over the near-term. Yes, we know that's boring!

Yet on balance, we must say the evidence remains tilted toward the bullish camp – meaning we should continue to give the bull every benefit of doubt.

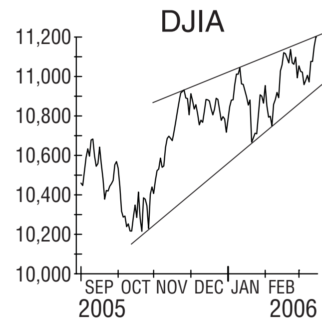


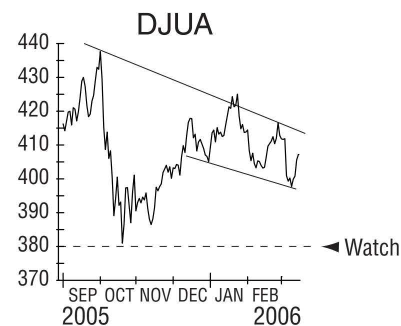
✻1 SELLING VACUUM [-BULLISH-]: This confirms the absence of negative or downside leadership. It is normally a very bullish signal since a stock market without any downside leadership is destined to move much higher.

✻2 DISTRIBUTION [-BEARISH-]: This signals that investors are anxious to sell stocks regardless of whether their position is at a loss, or the stock market is tumbling to new lows. It carries bearish implications as it suggests investors will use any rallies to get out of the market.

Breadth & Bellwether (divergences) ➞

Our A/D Divergence Index is showing slight deterioration [graph in our previous issue], but nothing that would be considered a bear market warning flag. A greater concern lies in the bellwether DJ Utility Average. It has been in a downtrend of declining peaks and bottoms (except the October bottom) since last autumn. There are a number of times in history when the interest rate-sensitive utility stocks have provided advance warning of broader market trouble. We would not consider this divergence serious <u>unless</u> the DJUA breaks under the October-November lows.





Last Minute Thoughts

We aren't the only ones concerned about the systemic risk of derivatives. The President of the New York Federal Reserve recently broke ranks with departing Chairman Greenspan's endorsement of the derivatives markets: ➞

And that comes from the only regional Federal Reserve Bank President who is a <u>permanent</u> member of the FOMC.

So while our technical models remain favorable, our enthusiasm is tempered (to say the least) by the growing risks in the housing market and from rising bond yields. Please monitor our InvesTech hotline at least once between issues for any critical changes... as models can deteriorate quickly at this stage of an aging bull market.

Fed's Geithner Says Wary of Derivatives Risks

While noting the recent resilience of financial markets to adverse events, New York Federal Reserve President Timothy Geithner said this strength should not turn into complacency in the face of magnified risks…

He argued that the sheer size and depth of financial transactions occurring daily could increase systemic risk rather than mitigating it, by amplifying movements in asset prices.

New York Times *– 2/28/06*

SPECIAL NOTE: M3 – The Great Coverup?
On March 23rd, the Federal Reserve will discontinue the publishing of M3 money supply. Some believe this is an attempt by the Fed to hide massive re-inflation efforts. We discuss this hot topic in a one page special attachment that is available when you download the electronic version of this issue [V06I04] from our web site at <u>www.investech.com</u>.

LAS VEGAS MONEY SHOW – MAY 15-18, 2006

Don't miss InterShow's most popular investment conference, the **18th Annual Las Vegas Money Show, May 15-18, 2006** at the Paris/ Bally's Resort. With a Special Show Focus on Buy-and-Hold and Trading, this conference is an excellent opportunity for an all-important mid-year checkup of your portfolio and investment strategy.

Best of all, the **Las Vegas Money Show** is a great time to meet with Editor Jim Stack face-to-face, visit with other InvesTech subscribers and get answers to your individual investment questions, at our exclusive **Subscribers Only Workshop** to be held Wednesday evening, May 17. Space is limited, so please call our office today at 406-862-7777 to reserve your seat.

Act now to secure your registration. Simply call **800-970-4355** *(and mention priority code #005898)* to qualify for FREE admission for you and a guest or visit www.lasvegasmoneyshow.com.

InvesTech's Financial Hotline Number Will Change…

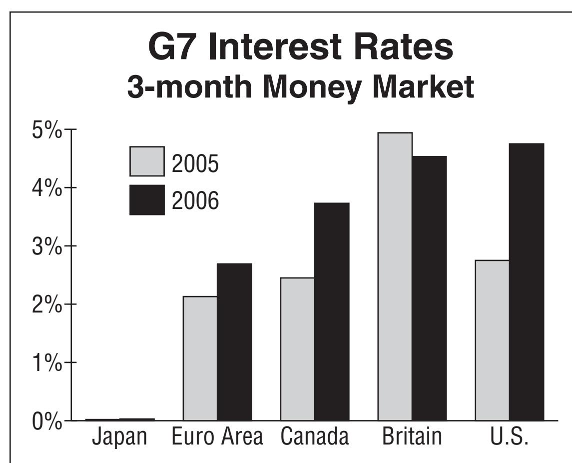
… April 3, 2006. For current subscribers, the new hotline card is enclosed with this issue. If you misplace this number or would like information on obtaining a long-term number that does not change quarterly, simply call our office at 406-862-7777. **PLEASE REMEMBER: This hotline number, as well as your Internet username and password, are confidential and for the use of just one individual per subscription. Sharing this confidential information will result in an immediate, non-refundable cancellation of your subscription.**

Global Outlook and Update

Even From a Global Perspective, Interest Rates Do Matter!

Interest rate hikes are cropping up frequently in the headlines these days – not just here in the U.S. but on an international basis as well. That's not surprising after three years of synchronous global economic expansion. At this stage, most economies are anxious to stay ahead of the curve when it comes to potential inflationary pressures, but rising interest rates can spell trouble for the world's stock markets.

With the next FOMC meeting just around the corner, let's see where U.S. rates stand compared with other countries. The chart at right ranks the current 3-month money market rates among developed G7 nations – from the lowest in Japan at .03% to the highest in the U.S. It also shows how these rates have changed over the past year. Keep this chart in mind as we take a look at how monetary policy, from the most accommodative to the most aggressive, has played out among the world's major stock markets…

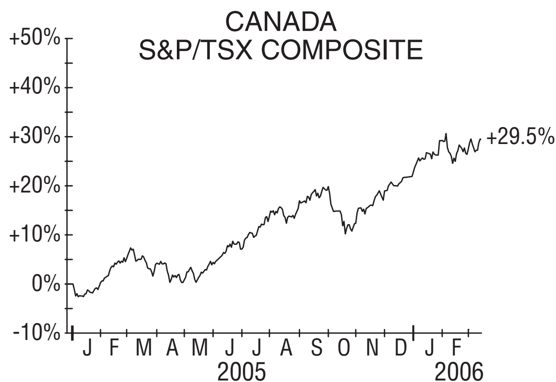


← Japan

Short-term rates have hovered near 0% for the past 5-years, allowing Japan's economy to finally get a good start on a sustainable economic recovery. While the Bank of Japan has signaled a change in policy is imminent, interest rates aren't expected to increase soon. Between Japan's improving economic picture and its super-easy monetary policy, the Tokyo Nikkei has been the biggest gainer among these charts, rising an impressive 41% in just over 14 months.

Euro Area

Germany has had trouble getting its economy on a consistent growth track, hence the European Central Bank has been reluctant to raise rates. Interest rates have increased just .5%pt from their low in the past three months. Meanwhile, Germany's DAX Index has turned in a hefty 37.9% gain.



← Canada

Like the U.S., Canada has been inching rates higher for nearly two years, but not with the same persistence. March 7 marked only the 5th rate hike during the period, leaving Canada with the third highest interest rates among these regions. As shown here, Canada's TSX Composite has performed well, but not enjoyed the stellar gains of regions where monetary policy has been more accommodative.

Britain

Britain has consistently held interest rates higher over the last 5 years than its G7 counterparts. Although the Bank of England cut key rates a notch in 2005, the 3-month money market rate is still over 4.5%, barely less than the U.S. at this stage. While the 23.5% gain in London's FTSE Index is a great return for the period, it has not kept pace with Canada's TSX Composite.

← U.S.

While the Fed has taken a "measured" approach to raising rates, U.S. policy has been more aggressive than the others reviewed here. With 14 consecutive rate hikes in 20 months, and a 15th almost certain to be implemented on March 28, short-term money market rates in the U.S. have increased the most over the past year and are currently the highest among G7 nations. Consequently, the S&P 500 has seen only a meager 7.1% gain since January 2005.

Conclusion

Interest rates do matter, both here in the U.S. and on a global basis. Where monetary policy has been most accommodative, stock markets have soared. Conversely, markets in the U.S. and Britain –where short-term rates are the highest– have lagged. More important, the bar chart shown earlier is still changing. With the exception of Britain, these headlines show that global interest rates are expected to move higher, meaning stock market gains will likely moderate as monetary policy tightens.

Bank of Japan Abandons Super-Easy Monetary Policy
***Wall Street Journal** – 3/9/06*

Bk of Canada Hikes Rates Again, "May" Increase Further
***Wall Street Journal** – 3/7/06*

Fed's Guynn Says Market Rates Are 'Accommodative'
"Despite the removal of very accommodative Fed monetary policy, credit markets are still accommodative," Guynn said… "This liquidity could boost the economic expansion and contribute to stronger-than-expected inflationary pressures."
***Bloomberg** – 3/16/06*

European Bonds Decline on Speculation Rates to Rise Twice More
***Bloomberg** – 3/13/06*

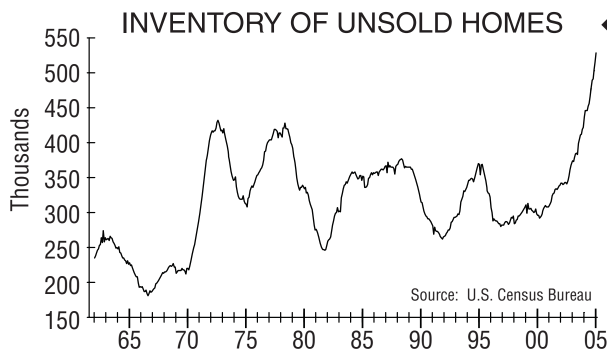
As for international investments, we believe Japan continues to offer the best prospect for economic expansion among developed nations this year, and even if interest rates inch higher toward year-end, Japan's monetary policy by comparison will remain by far the most accommodative.

"The boom is over…"

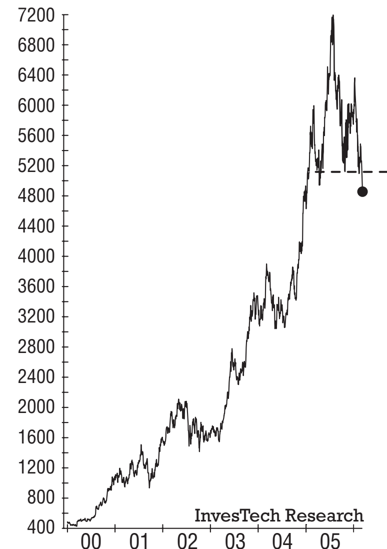
"…investors are pulling out in a lot of the nation's hot markets, and that's adding to the cooling."

Chief Economist – National Association of Realtors
***Wall Street Journal** – 3/1/06*

To understand the irony, you'll have to read the confident reassurances from this same NAR chief economist in the *Personal Perspective* of our previous issue (February 24).



The latest statistics reveal the inventory of unsold homes has risen to a 5.3-month supply – the largest in almost eight years. And that's based on trailing sales, not where sales are likely headed! So it's little wonder that our leading index on the housing boom –or should we say "bubble"– has broken the important support level.



If this Bellwether Index keeps falling over the next 6 months, expect the unwinding news to get ugly. Meanwhile we continue to hear regional hissing sounds that seem to be anecdotal evidence of numerous simultaneous pinholes in the bubble…

Pssssst: That sound you hear…

NATIONAL FORECLOSURES INCREASE IN EVERY QUARTER OF 2005

RealtyTrac™, the leading online marketplace for foreclosure properties, today released year-end data from its 2005 U.S. Foreclosure Market Report, which showed that 846,982 properties nationwide entered some stage of foreclosure in 2005, and a 25 percent increase in the number of new foreclosures from the first quarter to the fourth quarter.

***RealtyTrac Inc.** – 1/23/06*

Home listings dwarf sales

Real estate experts unsure of what it portends

More than 3,200 metro Milwaukee homes sprouted "for sale" signs last month, over three times the number reported sold, a Friday industry report shows. That new inventory was 43% higher than January 2005 and 66% higher than January 2004.

***Milwaukee Journal Sentinel** – 2/11/06*

Real estate continues to cool

Fran Floyd took her Houston townhome off the market Sunday after nearly six months – even though she was willing to sell it for $3,400 less than she paid in 2002.

"It's just sad," said Floyd, 81. "I've got to sell. I don't know what I'm going to do. What I'm thinking about and praying about is renting it for a year, hoping the real estate market gets better."

***USA Today** – 2/28/06*

48% home sales drop leads state

The Sarasota-Bradenton market had the dubious distinction of being the Florida market with the biggest decline in sales during January: a precipitous 48 percent drop when compared with the same month a year ago – more than double the state's 19 percent decline…

The absorption rate of homes, or "weeks on hand," in the Sarasota County market, for example, has increased from 10.4 weeks in July to 73.3 weeks this month, an analysis of statistics supplied by the Sarasota Association of Realtors shows…

The absorption rate for [condominium listings] has gone from 14.3 weeks to 62.8 weeks.

***Herald Tribune** – 3/1/06*

The number of home and condo sales declined steeply across South Florida in January compared with January 2005, the **Florida Association of Realtors** said last week. The number of existing homes sold in January was the fewest in one month since February 1997 in Palm Beach County. In Broward, the January sales were the fewest in a month since the Realtors group started compiling housing data in 1994.

***South Florida Sun Sentinel** – 3/5/06*

Home builder sentiment sours in March

An index of U.S. home builder sentiment fell in March to the lowest in nearly three years in response to rising mortgage rates and softening demand.

***Reuters** – 3/15/06*

(Continued on page 8…)

(Continued from page 7...)

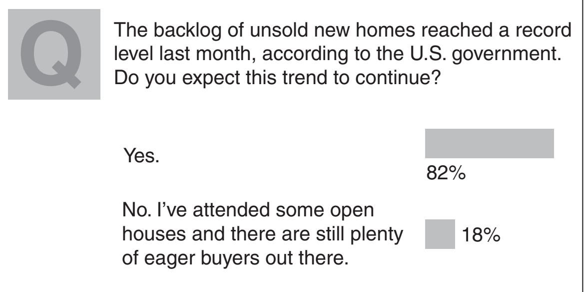
For many, this is a rude, if not sad, awakening from the boom times. Nobody likes it when the punch bowl is taken away and the hangovers begin to set in. And the Fed's 14 relentless rate hikes have certainly taken away the punch bowl from the housing party. Low introductory interest-only or variable-rate mortgages are a thing of the past.

Other respected organizations now acknowledge the growing risk to the economy:

> **$6.5 trillion**
>
> **The run-up in the housing market is approaching the size of the stock-market bubble that burst in 2000.**
>
> ***AARP*** *– March&April 2006*

And even the public is starting to recognize that changes are underway:

Yahoo! FINANCE POLL



Loyalty – Our Most Valuable Asset

As we approach our 24th anniversary in publishing **InvesTech**, I have often thought about how unique our relationship is with our subscribers. First, most newsletters don't survive five years, let alone a quarter of a century. Second, I'm surprised how many of those early subscribers are still with us… yes, even through our high-cash mistake of the late 1990s.

But then I realize that most of our mistakes have been on the side of excess caution – which is our preference, since profit opportunities always come around again. Our only two periods of holding 100% cash – in 1987 and the late '90s – turned out to be fortuitous in the aftermath of the subsequent bear markets. Yet it was undoubtedly our overall, long-term performance that has kept our subscribers so loyal. In the January 2006 issue of the *Hulbert Financial Digest*, we earned the #3 rank in Risk-Adjusted Return over the past 20 years that Mark Hulbert has tracked us. Of greater importance to our conservative nature, our RISK rating (as measured by volatility) was far lower than any of the top 6 contenders – and only ½ the benchmark RISK level of the Wilshire 5000 Index.

Important changes to InvesTech: We have always encouraged subscribers to utilize full access to InvesTech services, which include our twice-weekly hotline and Internet web site. Over 80% of our subscribers are now registered for online access and are downloading this newsletter on the day of publication.

If you have a computer and access to the Internet, it is important to register for our www.investech.com web site. [If you have problems, please call our office at 406-862-7777 and ask for Internet support.] The reason is that as we improve and enhance our services, more information will be available electronically. We simply cannot provide these new services by "snail mail" without increasing our costs and, of course, our subscription price to you. Today, among the most popular newsletters that have been around for 15 years or more [see table], we provide the most extensive service at the lowest cost.

Investment Newsletters

Name	Frequency	Price Per Year
Band's Profitable Investing	Monthly	$199
Bob Brinker's Marketimer	Monthly	$195
Dessauer's Investor's World	Monthly	$249
Eliades' Stockmarket Cycles	Monthly	$252
Fabian's Successful Investing	Monthly	$349
Growth Stock Outlook	Twice per month	$235
Investment Quality Trends	Twice per month	$310
Murphy's Technology Investing	Monthly	$395
Navellier's Emerging Growth	Monthly	$995
OTC Insight	Monthly	$295
Prudent Speculator	Monthly	$295
Weiss' Safe Money Report	Monthly	$189

Not to fear! We are not about to dramatically increase our subscription rates. In fact, you will soon receive a special *"InvesTech Subscriber Loyalty Promotion"* that allows you to extend your subscription for up to 5 years at unbelievably low rates. It's our best way of saying "Thanks!" to our most loyal subscribers (and pass along the savings of annual renewal notices). And in the coming months, look for important changes to enhance the content and timeliness of the investment information we provide through our Internet web site and InvesTech newsletters.

James B Stack

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M3 – The Great Coverup?

With little fanfare, but amidst underground criticism, the Federal Reserve will soon discontinue publishing M3 money supply on March 23. Cynics believe the Fed is trying to cover up their inflationary agenda:

Secret M3 Monetization Scheme

Conspiracy Nation

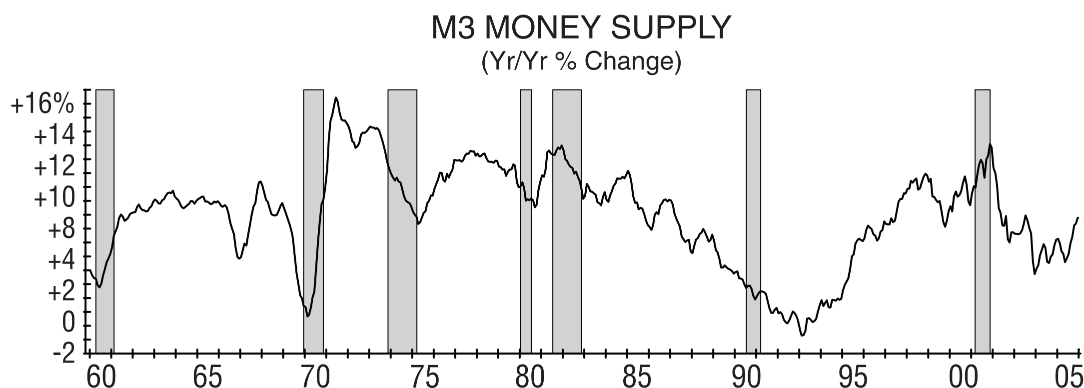
M3 becomes a liability for the Fed

Elliott Wave Technology

Even the Nobel-winning monetarist Milton Friedman admits, *"I don't know why the Federal Reserve discontinued the M3 chart."*

What's the Fed up to? Is there a secret agenda? Will inflation soon soar? Are we about to lose a valuable economic or inflation forecasting tool?

In response to the last question – we have tracked M3 in our database for over 25 years, and have yet to discover any link between M3 and the outlook for the economy, inflation, or the stock market. **Of all the money supply measures, M3 seems to be the most useless.** For example, as shown in the graph below, there is no visible correlation between M3 and recessions – even though everyone knows *"money is the fuel that makes the economic engine go!"*



You'll notice that recessions have begun when M3 is low and falling (1969 and 1990), as well as when M3 is high and rising (1981 and 2001). Certainly no help there.

And if overlaid with inflation, the correlation is even worse, or more misleading. Some thought the 0% growth in M3 during 1992-93 was forewarning of a deflationary accident. Instead, the U.S. enjoyed the longest economic expansion in history. Inflationists thought the double-digit M3 expansion of 1998-2001 could usher in a return of 1970s-style inflation. Instead, 2002-03 saw the first deflationary scare since the 1930s.

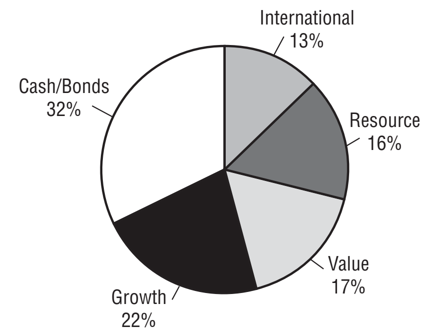
Miss it? Nope. Not us. We've found narrow money supply and M2 much more useful in monetary or market models. And while many of the components of M3 will still be available if one wants to track them, the thought of large-denomination time deposits, institutional money funds, and Eurodollars held by U.S. residents just doesn't get our analytical juices flowing!

INVESTECH® RESEARCH

PORTFOLIO STRATEGY

VOL06 ISS04 Safety-First Asset Allocation MARCH 17, 2006

THE INVESTECH MODEL PORTFOLIO is currently 68% invested with 13% in international funds, 16% in resource stocks, 17% in value securities and 22% in growth investments. The remainder of the portfolio (32%) is held in short-term Treasuries or a money market fund.

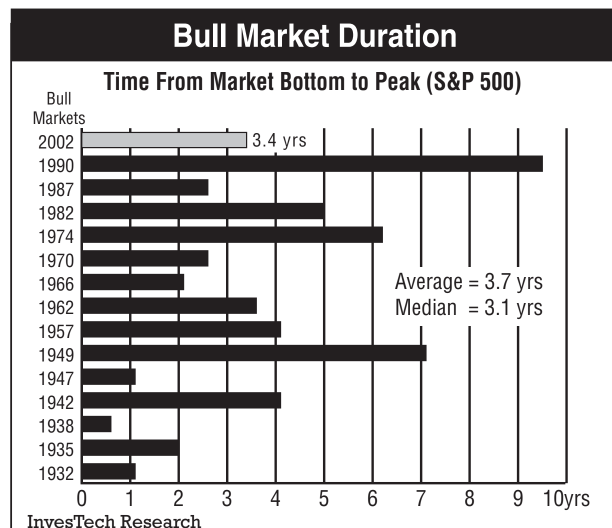


INSIDE THIS ISSUE: While the S&P 500 bolted out of the starting gate this year, gaining nearly 4% in just seven days, January 11 remained the stock market peak until this week. While we believe additional bull market profits are still possible, they are also more elusive… and the risks in this maturing economic recovery are increasing. In this issue, we help you weatherproof your portfolio by reviewing the key elements of our current strategy and identifying some of the characteristics that are a hallmark of defensive stocks.

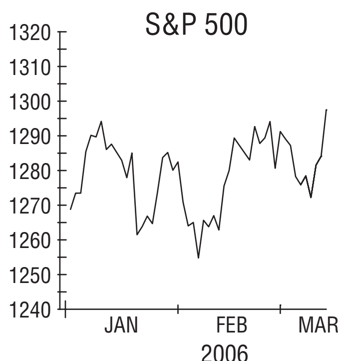
Developing an All-Weather Portfolio

If the first several months of this year are any indication, 2006 will be a tough year to navigate. We aren't surprised.

- The bull market is now well into its 4th year. Compared to the duration of previous bull markets shown at right, this cycle is well past the early stages where a rising tide raises all ships. ⟶
- The fear is growing that Fed rate hikes may not end anytime soon, as many analysts expected earlier in the year.
- Energy prices remain high in spite of ample fuel inventories and unseasonably warm weather.
- Employment and wage pressures continue to build – not uncommon in a maturing economic recovery.



The S&P 500 started off with a bang in the first seven trading days of January but it's made little headway over the last two months, only breaking out to new highs on this week's rally:



Still, our technical models suggest this bull market remains intact. Additional profits are possible and even likely, but the market is becoming more selective. Also, the picture could change quickly depending on how inflation and interest rate pressures evolve. The challenge for investors is to try and maintain an "all-weather" portfolio, one that continues to profit in a late-stage bull market, but offers some resilience if conditions worsen. With this goal in mind, let's review the key points in our portfolio strategy, and remember, this is not the time to swing for home runs…

- **Maintain a moderate cash cushion**, around 30-35% of the portfolio. Money market rates are currently around 4%, while 3- to 6-month Treasuries yield over 4.5%. The psychological pain of holding cash

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is not nearly as acute now as during the 2000-02 bear market when interest rates dropped to generational lows.

- **Stay diversified.** Don't put all your eggs in one basket, no matter how tempting. This was a common and fatal mistake during the technology bubble of the late 1990s.
- **Maintain a balance between value and conservative growth investments.** Each has its advantages under current market conditions, so it makes sense to include both in one's portfolio. From a performance standpoint, the Russell Midcap Value Index and Russell Midcap Growth Index have moved in tandem over the past 6 months. Moreover, according to the Leuthold Group, large-cap growth stocks are now significantly below their historical average P/E of 24.7.
- **Emphasize defensive sectors** such as Health Care, Staples, and Energy, which are all non-discretionary in nature. In addition, the Industrial sector may offer select opportunities… companies with solid balance sheets are far better able to spend and invest in growth than cash-strapped consumers. So, limit exposure to Consumer Cyclical, as well as Financial stocks, which could be vulnerable in this rising interest rate environment.
- **Look for defensive qualities in individual stocks.** The following section highlights those characteristics that should help keep a company on the right track as credit markets tighten, economic growth slows and risks increase.

Defensive Stock Characteristics

Evaluating the stocks to hold in your portfolio is more important than ever at this stage of the market cycle. The following is an overview of the defensive characteristics we look for in companies in a mature bull market. We've also listed our current portfolio "growth and value" stocks in the table below so our subscribers can see how they stack up in meeting these criteria.

First, **stock valuations** should be reasonable. Growth stocks and certain sectors often have P/E ratios greater than the S&P 500 average of 18.4, but valuation metrics should at least be in line with, if not below, the company's historic median. In spite of gains in our portfolio stocks below, only Renal Care Group (which is being acquired by another firm) is slightly above its 10-year median valuation.

Look for **solid revenue and earnings growth** over the last five years, which covers much of the 2000-02 bear market as well as the current bull market. For the S&P 500 Composite, the average 5-year growth rate for both parameters is about 7% annually. With the exception of BCE Inc. and Automatic Data Processing, the companies listed have generated average annual revenue and earnings growth of 9% or better for the period.

Well-protected dividends are important for stocks that decide to return some of their profits to shareholders. Paying out steady or increasing dividends is a sign of financial health in a company, and dividends can provide investors with a stable source of income… even during bear markets. Of this group, only BCE has a substantial dividend yield of 3.7%. Although the others are more growth oriented, all (except Renal Care) pay a dividend and have consistently raised payments over the last few years while keeping the payout ratio to less than 45% of net profits.

International sales help offset vulnerability to declining consumer confidence and a potential bear market in the U.S. All the companies in our portfolio have expanded into international markets. In fact, over half the revenue for Dentsply and AFLAC is generated overseas, and Canadian telecom company BCE is based entirely outside the U.S.

Companies with a **low Debt-to-Capital Ratio** are better situated to survive as interest rates rise and the credit market becomes more hostile. The companies below have all been able to maintain growth and dividends while limiting long-term debt to less than 45% of capital.

Finally, look for unique defensive aspects to a company's business. For instance, Automatic Data Processing benefits from the float on processing corporate payrolls when interest rates rise. PepsiCo is a leader in food products where sales tend to be resilient even in recessions. BCE dominates telecom services in Canada where the market is still highly regulated, unlike the U.S.

The remaining stocks in our Model Portfolio are not listed in this table as they fall under the resource

InvesTech Portfolio
Growth and Value Stocks

Company	Sector	P/E	5-yr RPS Growth	5-yr EPS Growth	Yield	Int'l Sales	Debt / Capital	Comments
Renal Care	Health Care	24	20%	19%	0.0%	10%	42%	Completion of RCI acquisition expected 3/31/06
Dentsply Int'l	Health Care	21	16	17	0.5	57	35	Growth in dental care across all socio-economic levels
AFLAC	Financial	16	10	16	1.1	75	15	Demographics in Japan even more attractive than U.S.
Auto Data Proc.	Industrial	26	8	5	1.6	20	2	AAA rated company that benefits from rising interest rates
Biomet	Health Care	22	17	17	0.7	34	0	27 consecutive years of earnings growth
PepsiCo	Cons. Staples	23	9	11	1.7	35	14	Premier consumer brands that are recession resilient
BCE	Telecom	14	2	3	3.7	95	41	Dividend raised 10% in 2005

InvesTech Research

category. This group has served as a sector hedge against high energy prices and a falling dollar. Here, we've placed emphasis on oil and gas companies with steady production growth and a focus on domestic production to avoid geopolitical risks.

While we may cut back the current over-weighting in this sector, it is still an important component of our defensive portfolio strategy.

Strategy

In the February 3rd issue we added iShares DJ Health Care to the portfolio to increase our exposure in this defensive sector and to replace Renal Care, which is being acquired by Fresenius Medical Care. That buyout should be completed by the end of March which will reduce our invested position to around 65%. This is still within our targeted range, but we may replace the position if our key indicators remain strong after the upcoming FOMC meeting.

MODEL PORTFOLIO

NEXT ISSUE: April 7, 2006

CHANGES SINCE OUR LAST ISSUE: No changes have been recommended to the model portfolio since the last issue. Continue to monitor the Financial Hotline or website at www.investech.com for important updates.

FOR NEW SUBSCRIBERS: Purchases after our initial recommendation must be made at your discretion. We generally advise bringing your portfolio in line with the following allocation as quickly as possible. Note that Renal Care Group (RCI) has agreed to an acquisition offer by Germany-based Fresenius Medical Care for $48 per share in cash. Existing subscribers should hold the position until acquisition is closed later this month. We do not recommend the purchase of Renal Care Group for new subscribers.

CURRENT ADVICE	PERCENT	COMPANY	SYMBOL/EXCH	52 - WEEK Hi	52 - WEEK Low	INIT. RECOMMENDED Date	INIT. RECOMMENDED Price	RECENT PRICE	P/E	YIELD
BUY/HOLD	6%	**ISHARES RUSSELL MIDCAP VALUE INDEX** Exchange traded fund designed to track the Russell Midcap Value Index.	IWS amex	131.19	107.88	9/8/04	@ 99.15	130.94	16	1.9%
BUY/HOLD	5%	**THE JAPAN FUND** Invests in Japanese securities and corporate debt. Holds about 60% of assets in small- and mid-cap stocks.	SJPNX ——	13.95	9.50	5/12/99	@ 7.71	12.65	27	0.0%
BUY/HOLD	4%	**ISHARES MSCI JAPAN** ETF that seeks to provide results that correspond to the performance of the Japanese market, as measured by the MSCI Japan Index.	EWJ amex	14.30	9.86	10/26/05	@ 11.83	13.68	21	0.4%
BUY/HOLD	4%	**T. ROWE PRICE NEW ASIA** Invests at least 80% of assets in China, Hong Kong, India, Indonesia, Malaysia, Phillipines, Singapore, South Korea, Thailand and Taiwan.	PRASX ——	12.73	9.32	2/28/05	@ 9.89	12.59	14	0.9%
BUY/HOLD	3%	**VANGUARD ENERGY FUND** This pure-energy fund has investments in most subsectors, but focuses on large, integrated oil companies.	VGENX ——	64.54	41.11	3/8/04	@ 30.83	58.77	18	1.2%
BUY/HOLD	2%	**NEWMONT MINING CORP.** World's largest gold producer and also #1 in gold reserves. Operates 22 mines on five continents and has a steady stream of royalty income.	NEM nyse	62.72	34.90	3/30/98	@ 29.68	48.61	49	0.7%
HOLD	4%	**RENAL CARE GROUP, INC.** Operates 410 outpatient renal dialysis facilities and provides acute dialysis services to 200 hospitals through a 33-state network.	RCI nyse	47.75	35.45	1/3/02	@ 20.67	47.75	26	0.0%
BUY/HOLD	3%	**ENCANA CORP.** One of the world's largest independent oil & gas companies active in the exploration, production & marketing of natural gas & crude oil.	ECA nyse	59.82	31.03	5/6/02	@ 15.68	42.86	11	0.6%
BUY/HOLD	4%	**AFLAC, INC.** The world's largest underwriter of supplemental cancer insurance, with operations primarily in Japan and the U.S.	AFL nyse	49.65	35.50	1/3/03	@ 31.60	45.90	16	1.0%
BUY/HOLD	4%	**AUTOMATIC DATA PROCESSING INC.** One of the world's largest providers of transaction processing, data communications, and information services.	ADP nyse	48.11	40.37	5/5/03	@ 33.73	47.69	24	1.5%
BUY/HOLD	4%	**EQUITABLE RESOURCES, INC.** An integrated energy company with emphasis on Appalachian area natural-gas production, transmission, and distribution.	EQT nyse	41.18	28.01	5/5/03	@ 19.31	36.23	19	2.4%
BUY/HOLD	4%	**DENTSPLY INTERNATIONAL INC.** Designs, develops, manufactures and markets dental products to over 120 countries under well established brand names.	XRAY otc	58.44	50.73	5/5/03	@ 36.53	56.03	21	0.5%
BUY/HOLD	2%	**BIOMET, INC.** One of the world's largest and most innovative designers and manufacturers of surgical implants for the replacement of hip and knee joints.	BMET otc	44.29	32.50	8/18/03	@ 29.46	35.37	23	0.7%
BUY/HOLD	4%	**DEVON ENERGY** Largest U.S. independent oil & gas producer with annual reserve growth of 15% over the past 15 years.	DVN nyse	70.35	40.60	1/21/04	@ 30.10	56.84	10	0.5%
BUY/HOLD	4%	**PEPSICO INC.** The world's premier consumer product company focused on convenient foods and beverages.	PEP nyse	60.34	51.75	9/8/04	@ 49.70	60.34	25	1.7%
BUY/HOLD	3%	**BCE INC.** Canada's largest communications company serving over 26 million customers.	BCE nyse	28.27	22.36	1/26/05	@ 24.07	24.88	13	3.7%[1]
BUY/HOLD	8%	**ISHARES DJ HEALTH CARE** Exchange traded fund designed to track the Dow Jones Health Care Index.	IYH amex	65.13	57.46	1/25/06	@ 63.65	64.21	24	1.0%

[1] Net dividend yield based on current exchange rate and adjusting for 15% foreign withholding tax.

ALTERNATE MUTUAL FUND PORTFOLIO

THIS PORTFOLIO IS OFFERED AS AN ALTERNATIVE TO OUR MODEL PORTFOLIO FOR SUBSCRIBERS WHO WISH TO LIMIT INVESTMENTS TO MUTUAL FUNDS.

CHANGES SINCE THE LAST ISSUE: No changes have been made to the Alternate Mutual Fund Portfolio since the last issue. Continue to monitor the Financial Hotline or website at www.investech.com for critical strategy updates.

FOR NEW SUBSCRIBERS: Purchases after our initial recommendation must be made at your discretion. We generally advise bringing your portfolio in line with the following allocation as quickly as possible.

PERCENT	FUND	SYMBOL	52-WEEK Hi	52-WEEK Low	INIT. RECOMMENDED Date	INIT. RECOMMENDED Price	RECENT PRICE	ALTERNATE FUNDS
36%	T-BILLS	----------	----------	----------	----------	----------	----------	MONEY MARKET FUND
15%	T. ROWE PRICE MID-CAP GROWTH	RPMGX	57.28	44.07	5/5/03	31.21	56.17	VANGUARD STRATEGIC EQUITY
10%	T. ROWE PRICE EQUITY-INCOME	PRFDX	27.10	23.86	4/12/04	22.37	26.93	See equity income funds below
10%	ARTISAN MID CAP VALUE	ARTQX	19.60	16.29	11/29/04	15.92	19.10	See value funds below
5%	THE JAPAN FUND	SJPNX	13.95	9.50	5/12/99	7.71	12.65	MATTHEWS JAPAN FUND
4%	MATTHEWS JAPAN FUND	MJFOX	19.52	14.96	10/26/05	16.23	18.03	See international funds below
14%	VANGUARD ENERGY FUND	VGENX	64.54	41.11	11/4/03	24.82	58.77	FIDELITY SEL. NATURAL GAS
2%	AMER. CENTURY GLOBAL GOLD	BGEIX	18.57	9.34	4/12/04	12.36	16.25	FIDELITY SELECT GOLD
4%	T. ROWE PRICE NEW ASIA	PRASX	12.73	9.32	2/28/05	9.89	12.59	ISHARES MSCI PACIFIC EX-JPN (EPP)

THE TOP-RATED FUNDS

FUND	SYMBOL	CURRENT PERF[1] 6wk	CURRENT PERF[1] 4 mo	PAST PERF[1] 2005	PAST PERF[1] 2004	PAST PERF[1] 5yr annl	SIZE[2]	YIELD	RECENT[3] PRICE	NTF[4]
GROWTH FUNDS										
ARIEL APPRECIATION	CAAPX	+ 0.9%	+ 3%	+ 3%	+13%	+ 9%	3235M	0.3%	47.64	F,S,W
➤ T. ROWE PRICE MID-CAP GROWTH[5]	RPMGX	+ 0.0%	+ 8%	+15%	+18%	+ 10%	15870M	0.0%	56.17	
T. ROWE PRICE SMALL CAP STOCK[5]	OTCFX	+ 0.3%	+ 9%	+ 8%	+19%	+ 12%	7386M	0.0%	35.09	
➤ VANGUARD STRATEGIC EQUITY	VSEQX	- 1.6%	+ 8%	+10%	+20%	+ 13%	6522M	0.9%	22.94	
VALUE FUNDS										
➤ ARTISAN MID CAP VALUE[5]	ARTQX	- 2.1%	+ 5%	+15%	+26%	N/A	2968M	0.1%	19.1	F,S,W
JANUS MID CAP VALUE	JMCVX	- 1.0%	+ 6%	+10%	+18%	+ 13%	4781M	3.6%	22.95	F,S,W
PENNSYLVANIA MUTUAL INV	PENNX	- 1.0%	+10%	+13%	+20%	+ 15%	2108M	0.0%	11.49	
➤ SOUND SHORE FUND	SSHFX	+ 0.1%	+ 4%	+ 7%	+15%	+ 7%	2496M	0.2%	37.36	F,S,W
T. ROWE PRICE MID CAP VALUE[5]	TRMCX	0.0%	+ 8%	+ 8%	+21%	+ 14%	5602M	0.6%	24.34	
EQUITY INCOME FUNDS										
AMERICAN CENTURY EQUITY INCOME	TWEIX	+ 1.3%	+ 5%	+ 2%	+13%	+ 9%	3730M	2.0%	8.10	F,S,W
VANGUARD EQUITY-INCOME	VEIPX	+ 1.2%	+ 5%	+ 4%	+14%	+ 5%	2758M	2.7%	23.78	
➤ T. ROWE PRICE EQUITY-INCOME	PRFDX	+ 0.9%	+ 5%	+ 4%	+15%	+ 6%	18472M	1.6%	26.93	
GOLD FUNDS										
➤ AMER. CENT. GLOBAL GOLD FUND	BGEIX	- 8.5%	+29%	+29%	- 8%	+ 31%	864M	0.0%	16.25	F,S,W
FIDELITY SELECT GOLD	FSAGX	- 5.7%	+28%	+41%	- 10%	+ 28%	1331M	0.1%	35.32	F
BEAR MARKET FUNDS										
➤ RYDEX SERIES TRUST URSA FUND	RYURX	+0.6%	- 3%	- 1%	- 10%	- 2%	329M	1.5%	8.12	F,S
PRUDENT BEAR FUND	BEARX	+ 2.4%	+ 4%	+ 2%	- 14%	+ 7%	430M	1.0%	5.59	F,S,W
NATURAL RESOURCE FUNDS										
FIDELITY SELECT NATURAL GAS	FSNGX	-13.0%	+ 8%	+46%	+40%	+ 13%	1571M	0.0%	37.91	F
T. ROWE PRICE NEW ERA	PRNEX	- 7.3%	+12%	+ 30%	+30%	+ 14%	4097M	0.8%	42.29	
➤ VANGUARD ENERGY	VGENX	- 7.3%	+13%	+ 45%	+37%	+ 20%	6103M	1.2%	58.77	
INTERNATIONAL FUNDS – ASIA/JAPAN										
➤ T. ROWE PRICE NEW ASIA	PRASX	- 0.6%	+16%	+26%	+19%	+ 15%	1602M	0.9%	12.59	
➤ MATTHEWS ASIAN GROWTH & INCOME[5]	MACSX	+ 0.1%	+10%	+16%	+21%	+ 20%	1763M	2.3%	17.85	F,S,W
FIDELITY JAPAN	FJPNX	- 6.9%	+16%	+43%	+11%	+ 8%	1872M	0.1%	17.63	F
FIDELITY JAPAN SMALL COMPANIES[5]	FJSCX	-12.8%	+12%	+41%	+22%	+ 16%	2086M	0.1%	15.13	F
➤ MATTHEWS JAPAN	MJFOX	- 6.5%	+ 8%	+15%	+22%	+ 8%	389M	0.2%	18.03	F,S,W
THE JAPAN FUND	SJPNX	- 8.1%	+13%	+24%	+12%	+ 8%	513M	0.0%	12.65	F,S,W

➤ Preferred Selection

1 % Return with dividends & capital gains reinvested
2 Net assets in millions of dollars
3 Price – Net asset value/share (NAV)
4 No Transaction Fee (NTF)

5 Closed to new investment
F – Fidelity NTF
S – Schwab OneSource
W – Waterhouse NTF

Data Sources: Morningstar Principia Plus
Investors FastTrack

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