Generations Advisors

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Outside The Beltstreet

May 2004

This Issue

Special points of interest:

- Deflation/Inflation
- Money Supply Growth
- Jobless Recovery?
- Market Perspective
- Insider Flight
- Consumer Confidence
- The Voice of Reason

Deflation vs. Inflation

Inflation: An **increase** in the **volume** of money or credit relative to available goods resulting in a substantial and continuing **rise** in the general price level.
Deflation: A **contraction** in the volume of money or credit that results in a **decline** of the general price level.

Source-Merriam-Webster Dictionary Online

As every place you turn discusses the oncoming inflationary crisis, very few comments are being made about the possibility of deflation. And yet something happened in the 4th quarter of 2003 that hasn't happened since WWII. The M3, the largest measure of the money supply, ***contracted*** 6.8% in that quarter. If the money supply, long term, begins contracting this would place us in a deflationary cycle, something we have not seen in over 60 years!

Now you might say, "Yes, but food, housing, gas...(you can add some others, I'm sure)...prices have been going up in the last several months." While this is true, it is also true that personal incomes, measured by average hourly earnings rose only 1.8% over the last 12 months ending March 2004. This is down from a 4.2% rise in the year 2000. So, as personal incomes slow, the only way for spending to continue at these levels is for the consumer and the government to keep going deeper and deeper into debt. The contraction in the fourth quarter of 2003 could indicate that borrowers are getting increasingly less comfortable in taking on additional leverage in the form of debt.

So if the, " I think I can, I think I can" debt and spending train starts losing steam, could we start sliding in the other direction? If so what would that do to the markets? Stay tuned. We may be facing something that no investor alive today has had to deal with yet...a contraction of the money supply.

Growth of the Money Supply: www.federalreserve.gov/releases/H6/hist/

DATE	DOUG'S LIFE EVENTS	M3 (IN BILLIONS)
October 1959	He turns two	292
September 1971	Starts High School	750
December 1983	Gets Married	2,681
May 1995	Last Son Drew is born	4,449
March 2004	Latest Data Available	9,033

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Doug Wakefield

Digitally signed by Doug Wakefield
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Market Noise

Are we just trying to find something to talk about?

> "March payrolls swell 308,000 in long awaited job breakout." *Homebound Mortgage. April 5,2004*

In this article we see an explanation for a big up day on the markets the day before. The optimism for this up day was explained in the article as follows:

> "After months of dashing hopes for a pop in hiring, the US economy finally delivered, adding 308,000 jobs in March, the best growth in four years. 'This was the very last piece of the puzzle to fall into place,' says Sherry Cooper, chief economist for Toronto based BMO Nesbitt Burns. 'This **will certainly** lead to higher consumer confidence and augment income growth, and so it's a very positive development.' (*emphasis mine)*

Hmm, you, the thoughtful investor ponder, "This really looks good, the markets ought to be up. However, today, April 2nd, the Dow declined 10 points?"

> "Companies add 288,000 jobs to payrolls in April; unemployment slips." *Channel 7 online, ABC News, May 7,2004*

> "I'm **officially** declaring the **jobless recovery dead**," says Ken Maryland, President of Clearview Economics. "I think we are now on the path of what will be **substantial** gains." *(emphasis mine)*

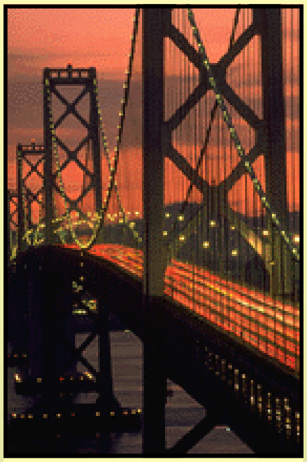
Again, you muse, "If there are an additional 288,000 jobs and things are improving, why did the Dow Jones Industrial fall 124 points today?"

Oh wait, I know. The economy is now **OVERHEATING**! Don't invest yet! The Fed must run to our rescue by raising interest rates to stop this. Right?

> "Wall Street walloped; stocks slump after strong monthly payrolls report sparks fears of a rise in interest rates." *CNN Money, May 7,2004*

> "While today's news is very positive, I think the market is likely to remain caught between **very good economic data** and the **worry that things aren't going to get better** from here," said Jeff Kleintop, chief investment strategist at PNC Advisors. *(emphasis mine)*

With market noise like this, is it any wonder that investors can't figure out what to do with their money? Maybe "economic news" and the pundits that talk about that "news" is driven by, rather than driving, the markets.



Will the next major move be to get into or out of the "stock market" city??

"I'm officially declaring the jobless recovery dead" says Ken Maryland, President of Clearview Economics

Technicals

	Beginning of Bear (Wave I Down)	
	Date	Level
Dow Jones Industrial	1/14/2000	11,722
NASDAQ Composite	3/10/2000	5,048

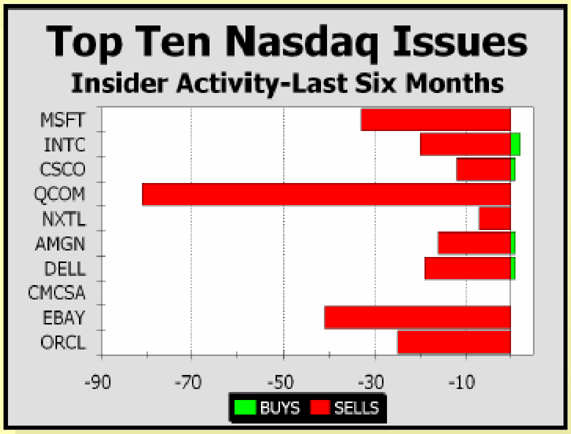
	Last Major Low (Wave II Up)	
	Date	Level
Dow Jones Industrial	10/9/2002	7,286
NASDAQ Composite	10/9/2002	1,114

	2004 Highs (Start of Wave III Down)	
	Date	Level
Dow Jones Industrial	2/19/2004	10,753
NASDAQ Composite	1/26/2004	2,153

	Current Levels (In Wave III Down)	
	Date	Level
Dow Jones Industrial	5/19/2004	9,937
NASDAQ Composite	5/19/2004	1,898

Yale School of Management – This index reflects a survey of individuals who are confident that there will not be a stock market crash in the next 6 months. The index began in October 1989. The higher the recorded number is, the more optimistic the views of those who were surveyed.

	Public Confidence Levels	
	10/2002	1/2004
Yale Crash Confidence	85.5	95.59
Michigan Consumer C	80.6 (10 year low)	103.8 (15 year high)



This chart represents the 6 months ending March 31,2004. Their were 8,830 sells for every 1 buy.

When you find it hard to sleep, think about these images.

Old 'Al. **Gold and Economic Freedom, by Alan Greenspan,1966**

"The excess credit which the Fed pumped into the economy spilled over into the stock market – triggering a fantastic speculative boom. Belatedly, Federal Reserve officials attempted to sop up the excess reserves and finally succeeded in breaking the boom. But it was too late; by 1929 the speculative imbalances had become so overwhelming that the attempt precipitated a sharp retrenching and a consequent demoralizing of the business confidence."
http://www.321gold.com/fed/greenspan/1966.html

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Three Questions you should be asking today.

1– If my account declines, how long do you think it will take for the markets to bring it back up?

2– What strategies could I use to make money (NO NOT REDUCE LOSSES) during a down market?

3– Since the Japanese had the largest creditor nation when they started their bear market in 1989, and are still in it today, and we entered our downturn in 2000 as the largest debtor nation in history, why do you feel that our bear market is over so soon?

Comments by New 'Al- A Speech to the American Economic Association, San Deigo, January 3,2004

"The notion that a well-timed incremental tightening could have been calibrated to prevent the late 1990 bubble while preserving economic stability is almost surely an illusion...much of the ability of the U.S. Economy to absorb theses sequences of shocks resulted from notably improved structural flexibility. But **highly aggressive monetary easing** was doubtless also a significant contribution to stability."

The Richebacher Letter, Monthly Analysis of Currencies and Credit Markets, November 2003: Dr. Kurt Richebacher

"Measured by quantity of money and credit growth, the Greenspan Fed's monetary policy is definitely by far the most successful in history. During the two-and-a-half years from the start of the recession-year 2001 to mid-2003, total **outstanding credit** skyrocketed by **$5.7 trillion**, of which $3.4 trillion was non-financial and 2.3 financial.

But measuring the traction of this fantastic money and credit creation on the economy, Mr. Greenspan's policy was the most ineffective in history, resulting during the same period in merely **$823 billion nominal GDP growth**. It took about seven dollars of new debt to generate one dollar of GDP growth. It was the highest debt-to-GDP ratio ever, and what's more, it keeps getting worse."