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By Gary E. Miller, C.F.P.

Contact Gary Miller at 949-249-2057
E-mail: Gary@trustedfinancial.net

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Why I left Wall Street …. and Why You Should Too…

"You don't have to read very far into the thousands of pages of damning e-mails and memos that securities regulators released on Apr. 28 to see what the game was about. Up and down Wall Street, analysts and investment bankers, under the watchful eye of management, turned the business of investing into a crass 'heads we win, tails you lose' proposition for investors."[1] So begins a *Business Week* article the subject of which is the record fines assessed on Wall Street firms for what amounted to a conspiracy to defraud at the highest levels of each company. Missing from this settlement was jail time for those who cooperated to puff up internet and technology issues, deceiving customers and often the customers men (and women) who pitched these investments to their clients, friends and relatives.

I left Wall Street, finding it impossible to reconcile my desire to provide low cost investments to match the objective advise I offered, and tired of the poor operational support.

"The key to the settlement, at least for investors, is <u>the pile of documents that prove you can't trust Wall Street</u> - no matter how big the name or how supposedly reputable the firm." *Michael Collins, CBS.MarketWatch.com, May 1, 2003 (Emphasis added)*

If you still have an account with one of the guilty brokerage firms, then the documentary proof that Wall Street firms conspired to take your money and put it into their pockets and those of their investment banking clients should be a wake-up call. Many folks have believed that the losses they suffered were simply the result of their own aggressive investing behavior. But often poor investment decisions were fueled by investment studies and well placed news stories from "analysts" whose predictions were primarily generated at the behest of upper management.

A key part of the recent settlement is that the big firms must provide and pay for independent research from non-affiliated analysts. No one from Smith Barney has phoned to receive my investment reports, but <u>you</u> can. I invite you to consider an advisory relationship with someone who owes favors to no one other than his clients.

Sun Rising Over Client Portfolios

Despite the shameful behavior of most of the big name brokerage firms, even their deceptions cannot obscure the long term advantage of including common stocks in a diversified portfolio. In recent months, I have had to plead with some clients, convincing them to "stay the course" and not to panic out of common

Certified Financial Planner™

Gary Miller is in his 30th year of providing financial guidance to individuals and pension plans. He is a Registered Investment Advisor and a Certified Financial Planner ™ Practitioner. Gary holds a Certificate in Personal Financial Planning from the University of California, Irvine and has served as a Board member of the Financial Planning Association, Orange County Chapter.

stocks, which still form the back bone of our long term growth strategy.

All major stock indices have trended upward since just before the removal of Saddam's government commenced. While we are "bottom-up" value oriented investors, and focus on individual company and industry fundamentals, I do look at technical indicators to get a feel for major trend changes. Moving averages, breadth indicators, put/call and sentiment ratios, daily price action, chart patterns and volume indicators may provide useful confirmation of an attractive fundamental situation, or a warning signal, but technicals are certainly nothing to bet the farm upon.

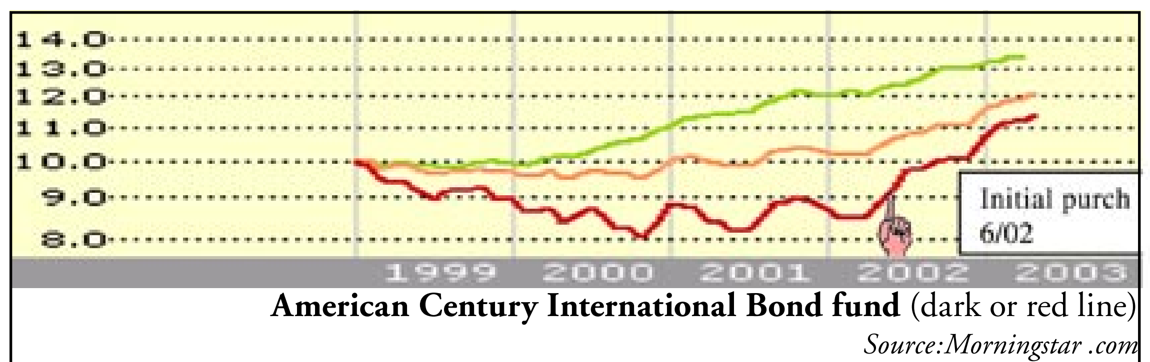
Still, it is intriguing to note that all major indices have risen above their 200 day moving averages for the first time in nearly a year. A number of respected technicians including Richard Russell of *Dow Theory Letters* and Dan Sullivan of *The Chartist* have flatly predicted an intermediate rally at the least, and a possible trend change to a real bull market at best. Because the indices have crossed their 200 day averages with no more than average volume, however, I am skeptical of the staying power of this rally. Also of concern is that the usual speculative suspects, chip stocks and internet darlings, are leading the charge. This is a worrisome sign, since buyers of these issues are usually speculators with little long term conviction.

Whether a trend change has occurred or not, our value oriented stocks have benefited nicely in this rally, and I've continued to add to those mutual funds and stocks that appear to be under priced relative to their intrinsic value.

Currency Markets Providing Good Returns

Diversification across asset classes is another pillar in my investment approach. Last year I began to include a 5% allocation to bonds denominated in foreign currencies. With the end to major hostilities in Iraq, we have not been surprised that those who predicted a dollar rally have been proven dead wrong. The dollar hit an all time low against the Euro in recent weeks, and client holdings of American Century International Bond fund are up 6.2% year-to- date and over 18% since we began purchasing the fund last June. While this is pleasing to clients, the causes of this success hold ominous implications for the economic future. President Bush wants Congress to stimulate the economy via a massive tax cut, which will send the Federal Deficit into orbit, and likely frighten foreigners who hold U.S. Government debt. No significant spending cuts are part of the President's budget proposal. Government debt is an I.O.U. our children and grandchildren will have to repay. What's worse, American industry has trouble competing with many foreign companies, especially China, so we import more than we export.[2] In the short run, it appears the Treasury and Federal Reserve want the dollar to fall so as to improve the competitive position of U.S. exporters and to make imports more costly to the American consumer.

Given my belief that the dollar has further to fall, our committment to international currencies was raised to about 7-8%.



American Century International Bond fund (dark or red line)
Source:Morningstar .com

Currency devaluation leads to imported inflation, rising interest rates and an economic slow down. Thus, the seeds of the next recession are being planted. If we are in fact in an economic rebound, it is unlikely to last more than two years before the aforementioned forces especially rising interest rates, cut it off at the knees. I worry about a return to the "Stagflation" epidemic that burdened stock market investors in the 1970's. In such a climate individual stock selection and portfolio diversification will be more important than ever. Having lived through such a time once before, I'm prepared to adjust client portfolios for what may come.

1. *Business Week online May 12, 2003. For full article go to http://www.businessweek.com/magizine/content/03_19/b3832026.htm*

2. *To the tune of a negative balance of trade of about $40BB per month*

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