



**Kenneth Coleman  
Author and Publisher of  
Kenneth Coleman's Investment  
Tracker Newsletter**

**Welcomes AAI Los Angeles Members  
July 14, 2007**

# The Economic & Business Cycle

## The 4 to 4-1/2 Year Business Cycle

Rising Interest Rates



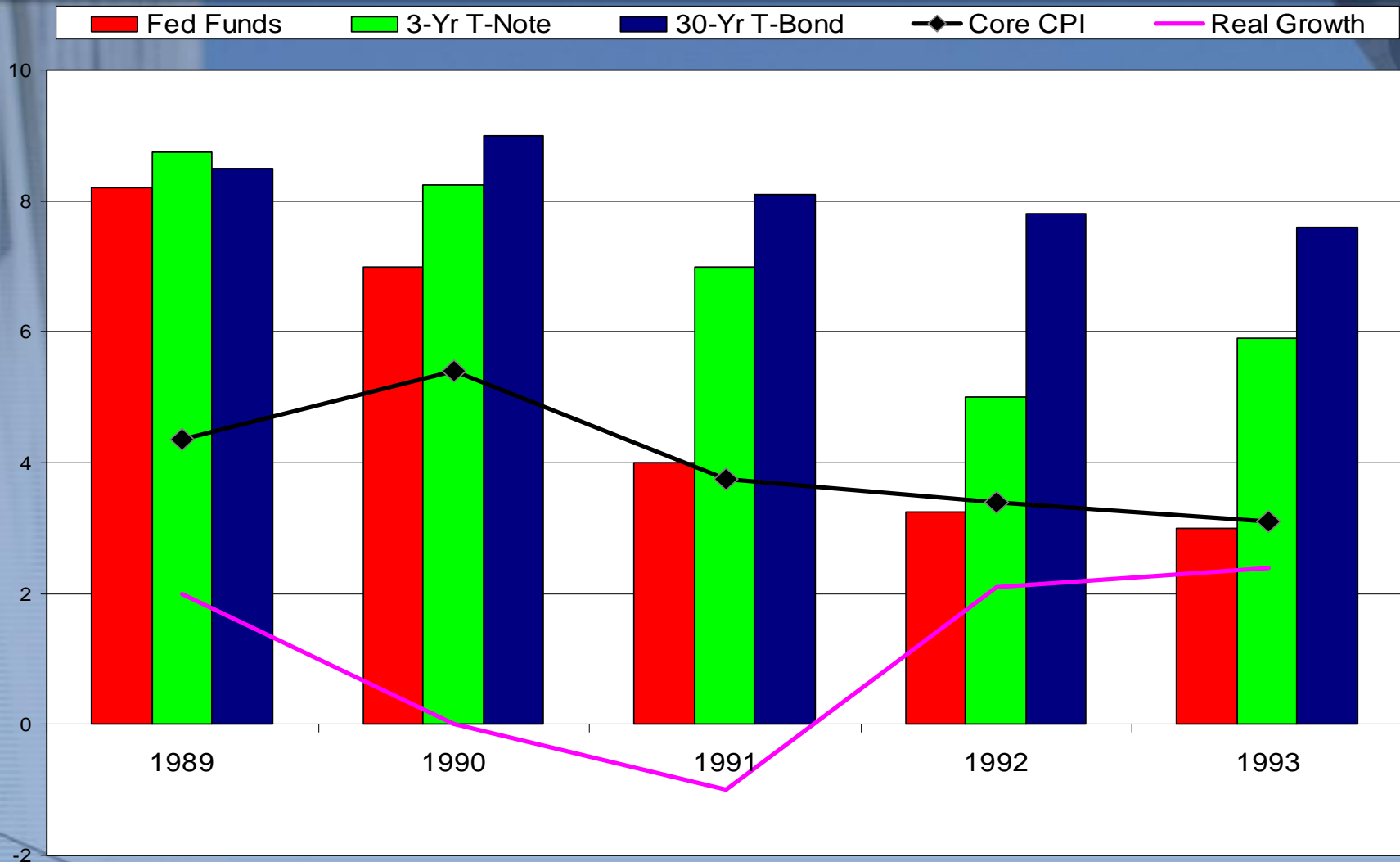
You are looking at a classic business cycle. When you learn how to understand and use the business cycle for your investment strategies, you will know the type of investments to buy/sell and when to buy/sell.

# The Hands of the Business Cycle's Clock

- Interest Rates and the Economy—An Historic Perspective
- The X-Factored Yield Curve
  - 1989-1993
  - 1994-1998
  - 1999-2000 (by quarter)
  - Yield Curve for 2003-2005
  - Current Yield Curve

# Interest Rates & the Economy

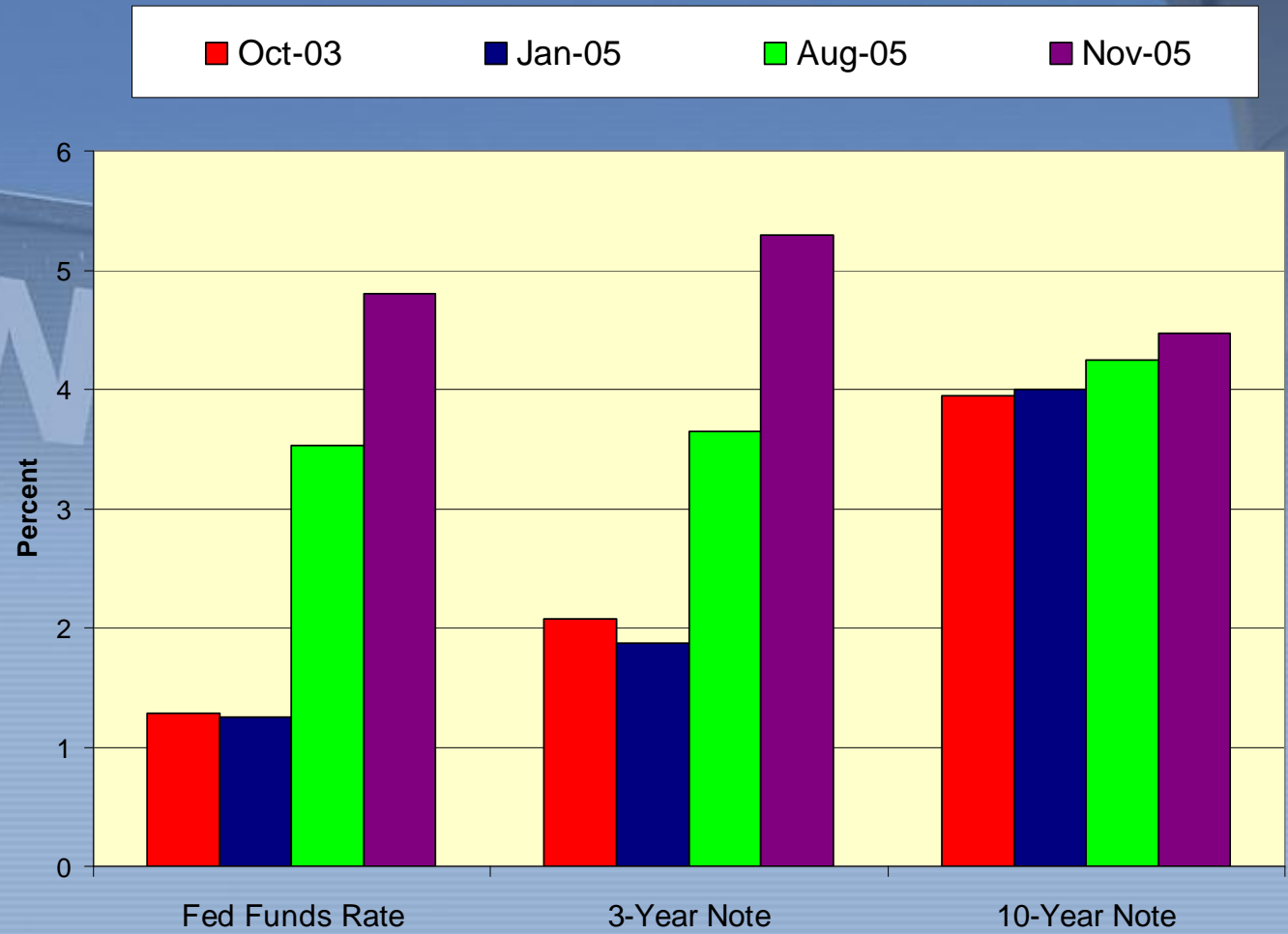
## An Historic Profile



# X-Factored Yield Curve

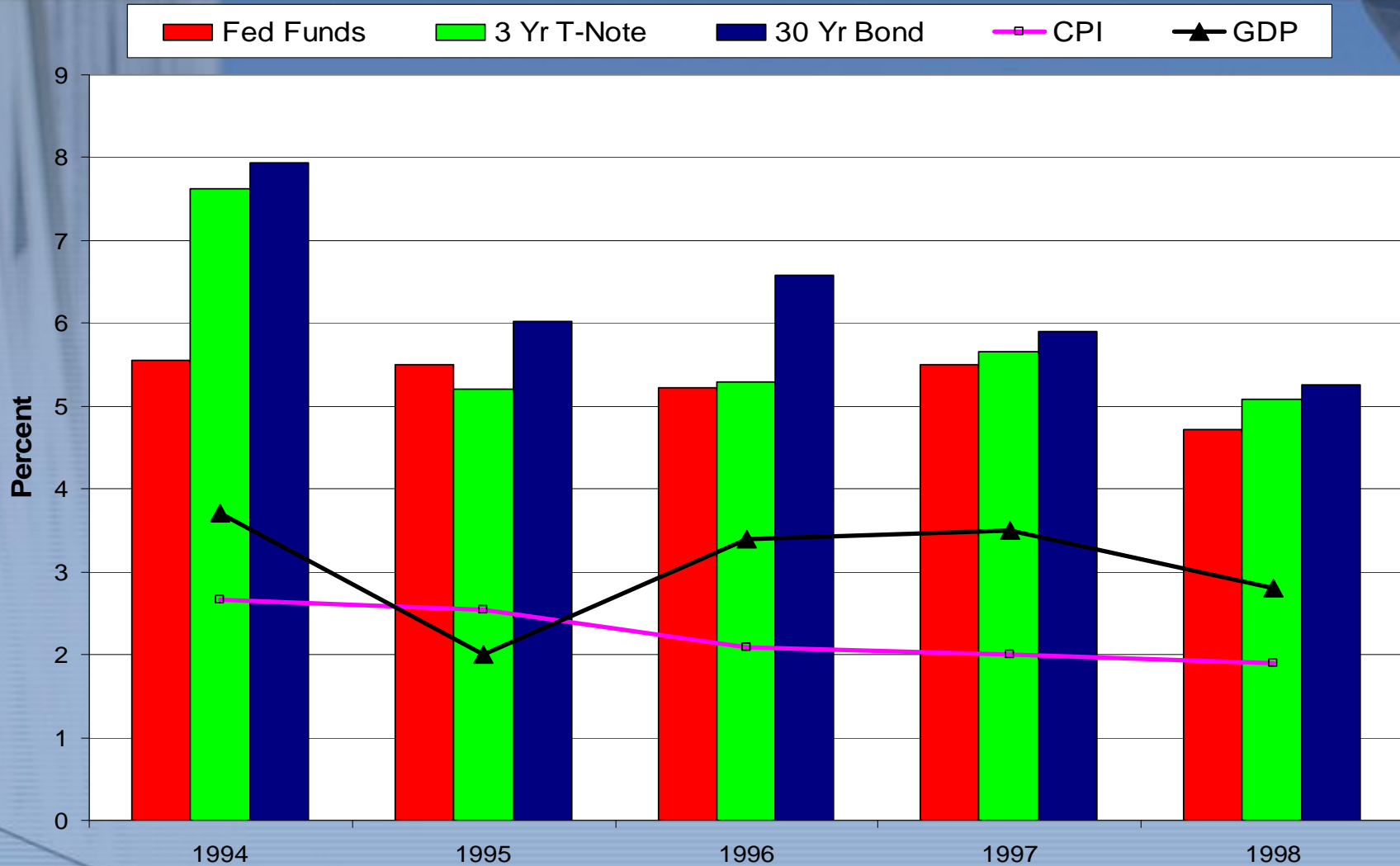
## Chart by Kenneth Coleman's Investment Tracker

**When you factor the yield curve for dollar value, you will note that it has become inverted. This means the pressure that is being exerted on our economy is pushing downward, not upward or sideways. This is why the price of crude oil is down, both at the pump and at the well head.**



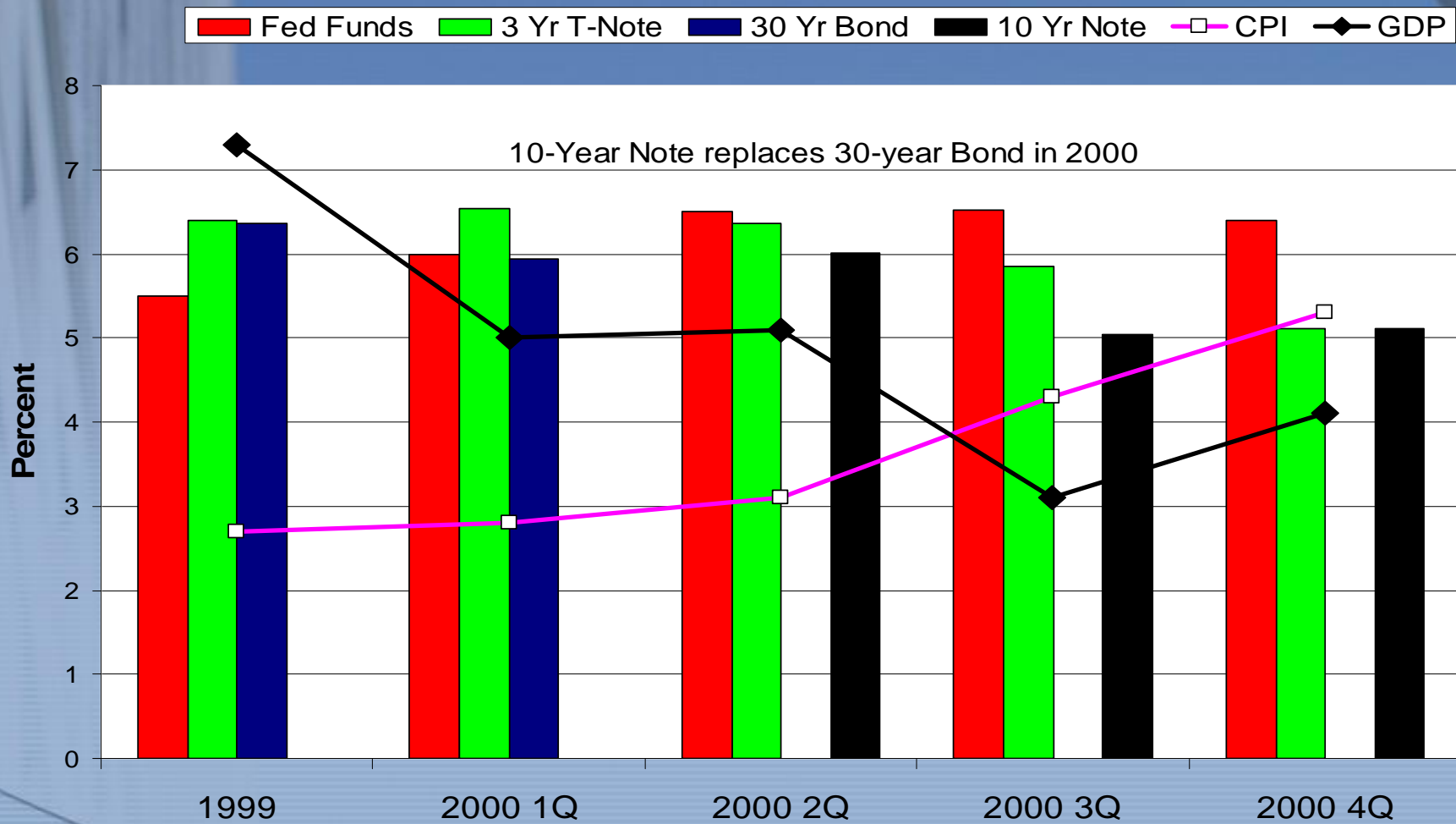
# Interest Rates & the Economy

## An Historic Profile



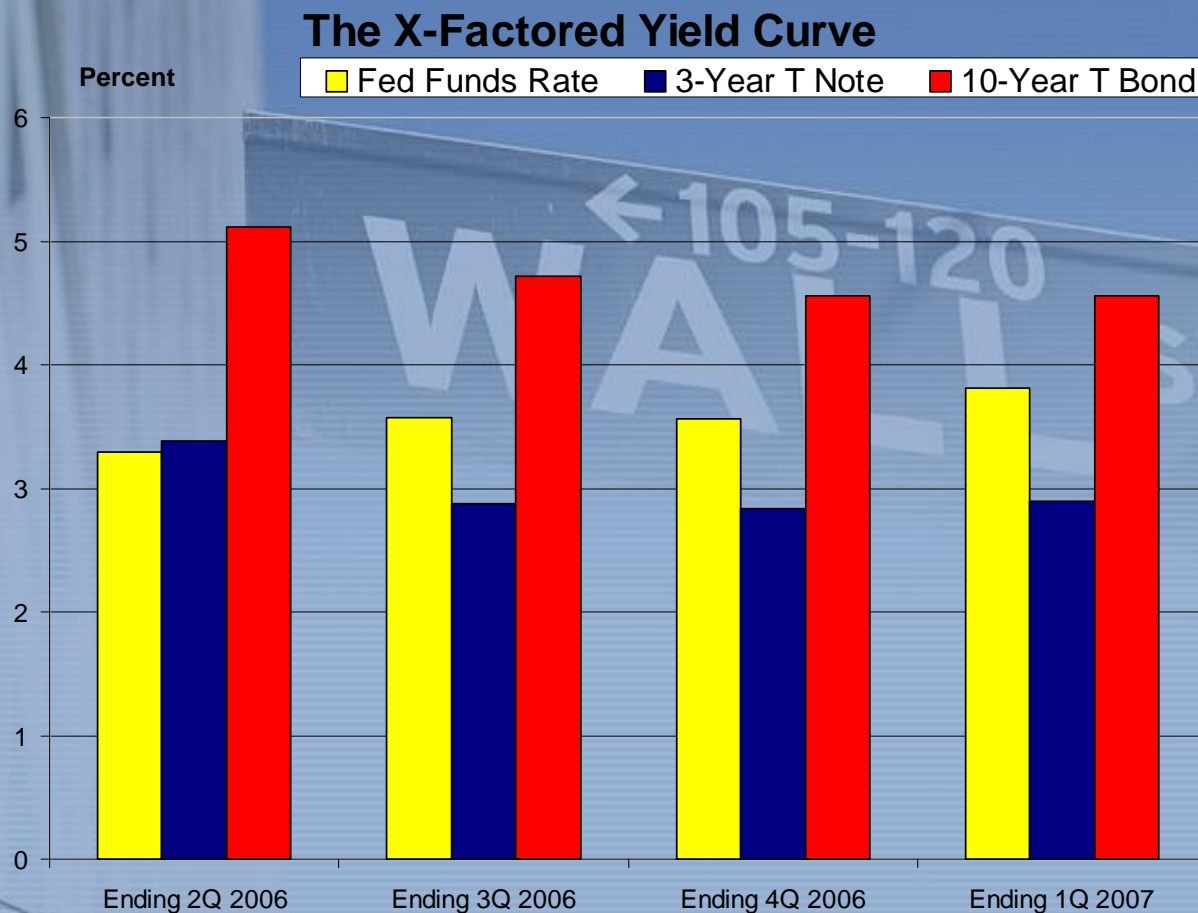
# Interest Rates & the Economy

## An Historic Profile





# The X-Factored Yield Curve

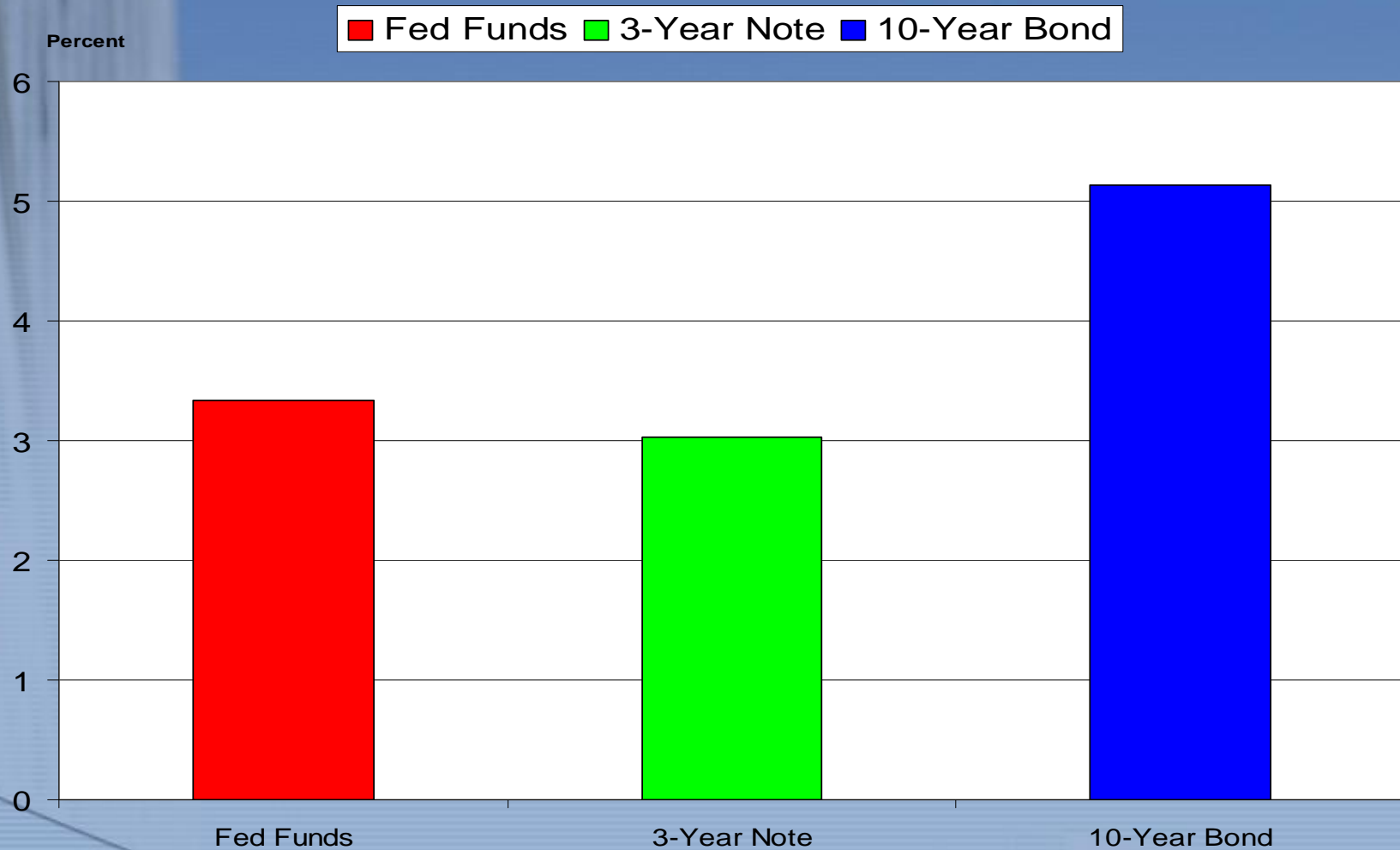


- The second quarter 2006 X-factored yield curve was compiled about 3-1/2 weeks before the market started to crash in May 2006.
- Starting at the end of Q2 the X-factored yield curve improved.
- It remained positive in 2006
- During the first quarter of 2007, the X-factored yield curve is still bullish, but not as bullish as in the previous quarters.



# The X-Factored Yield Curve

**July 2007**



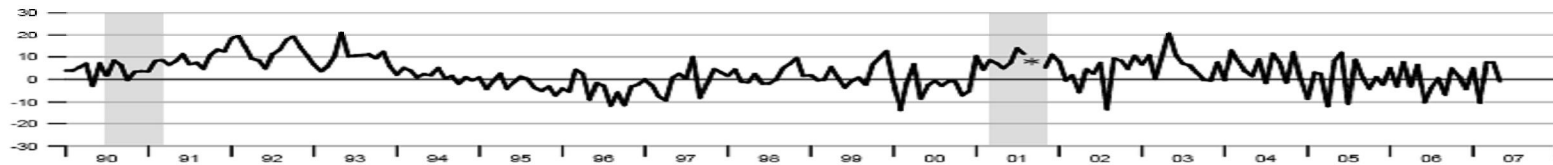
# St. Louis Federal Reserve Monetary Trends, June 15, 2007

## Monetary Trends

updated through  
06/15/07

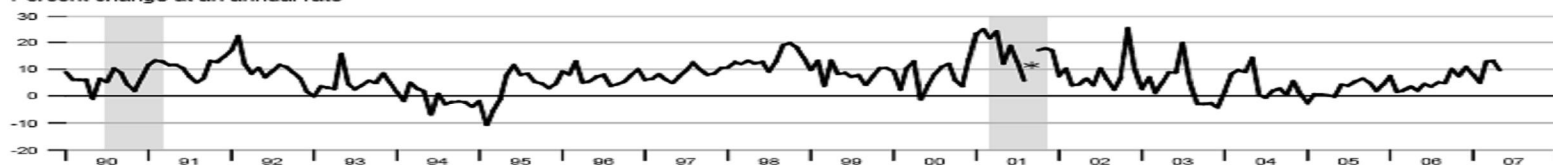
### M1

Percent change at an annual rate



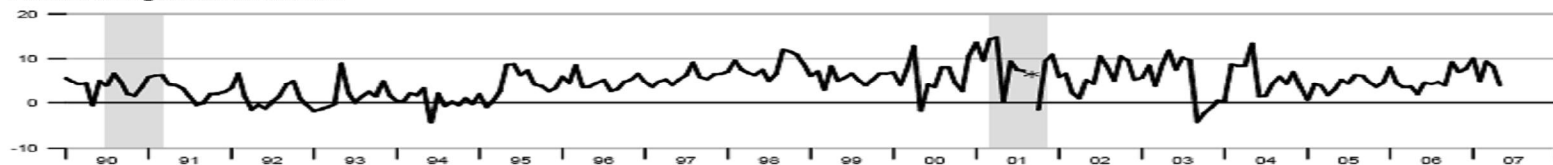
### MZM

Percent change at an annual rate



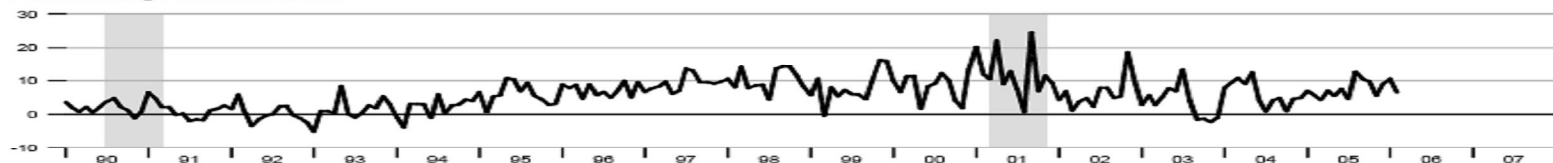
### M2

Percent change at an annual rate



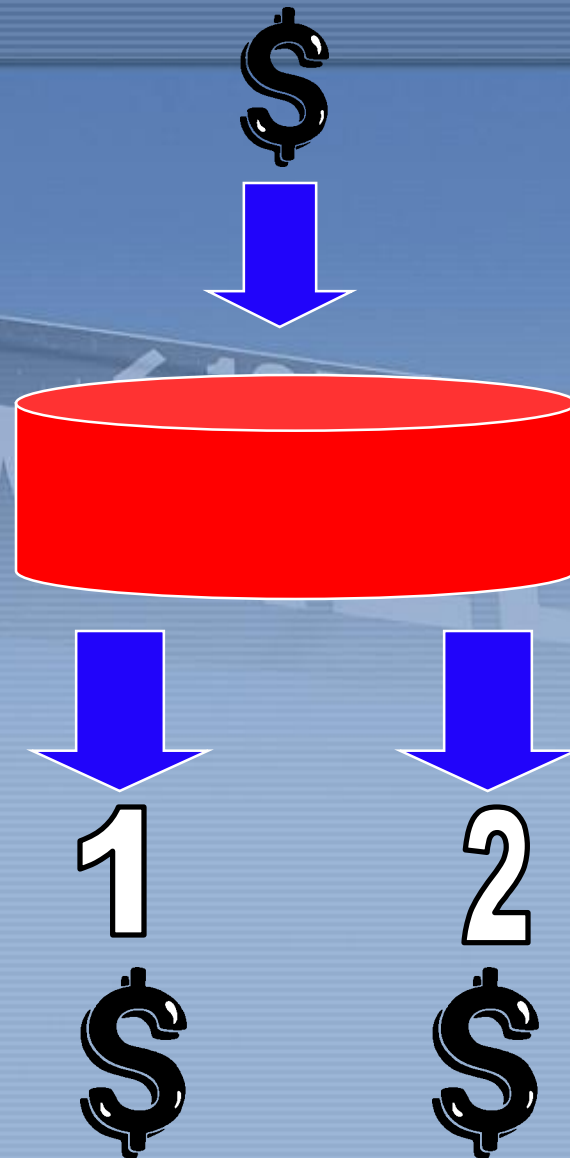
### M3\*

Percent change at an annual rate



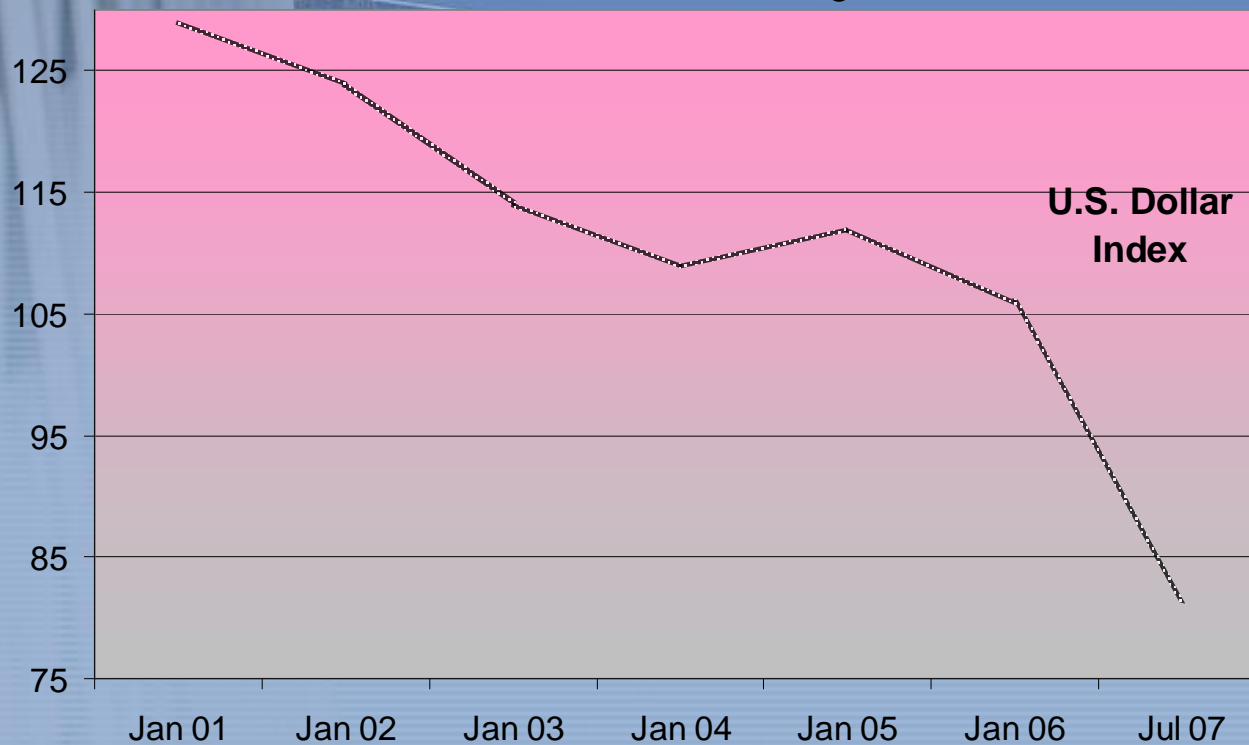
# Money Into and Out Of the Economy

The top arrow represents money going into the economy (red barrel), while the two bottom arrows represent money moving out of the economy. The majority of money into the economy is derived from loans (private and government). Arrow #1 represents default and paid-off debt. Arrow #2 represents money leaving the economy in various ways.



# U.S. Dollar Index

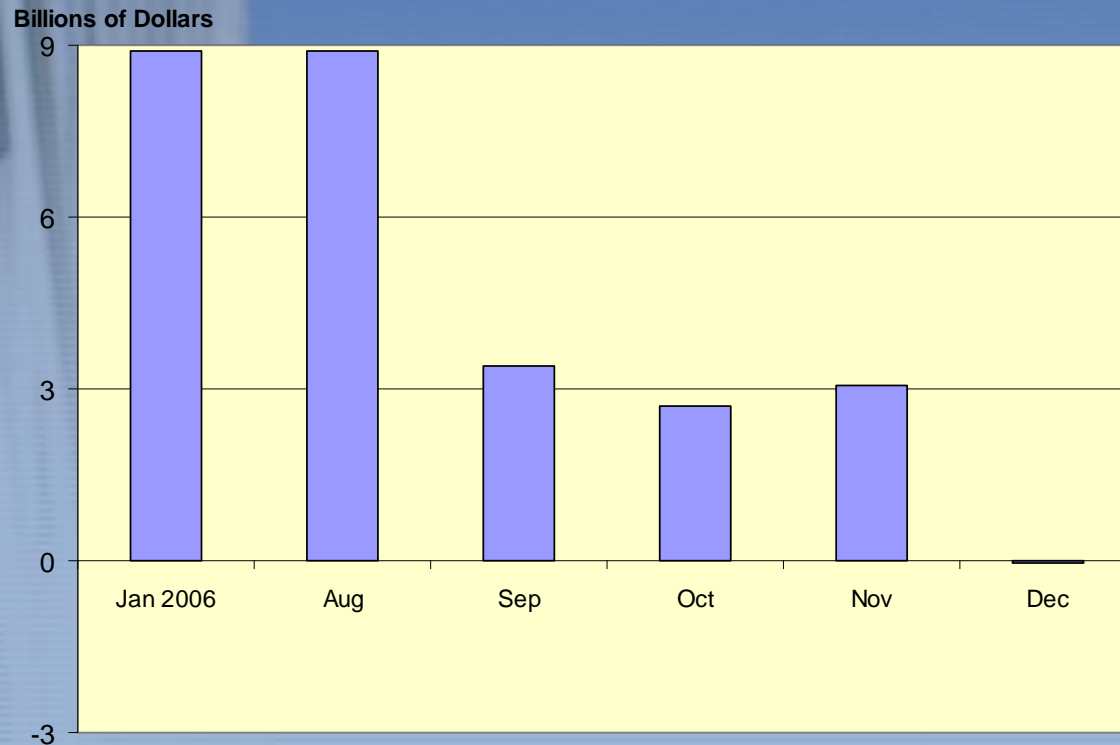
Sources: Federal Reserve, Global Insight, Business Week



The prospects for the U.S. economy and its interest rates (compared to those globally) will probably fall short of the mark. Even so, the U.S. must continue to attract large amounts of foreign investors. Lower dollar value pushes foreign investors into other currencies. It has fallen 40% since 2002.

# Inventory Growth Has Turned Negative

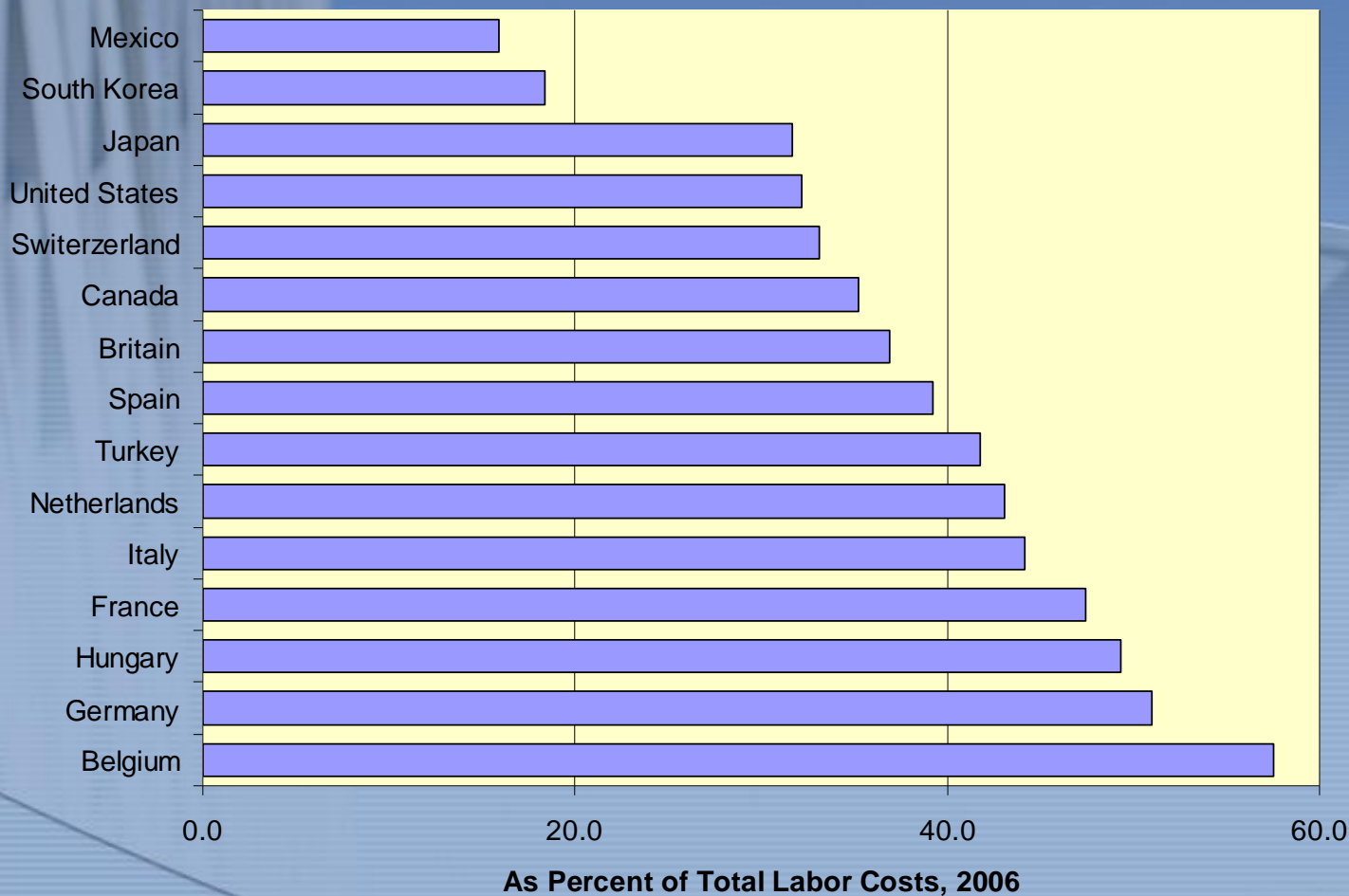
**Change In Business Inventories**  
Data: U.S. Census Bureau, Global Insight, Business Week



**The sharp drop in business inventories should lead to their bottoming in the near future. That would mean a pick up in manufacturing. When the sub prime loan debacle ends, the economy should start to hum again.**

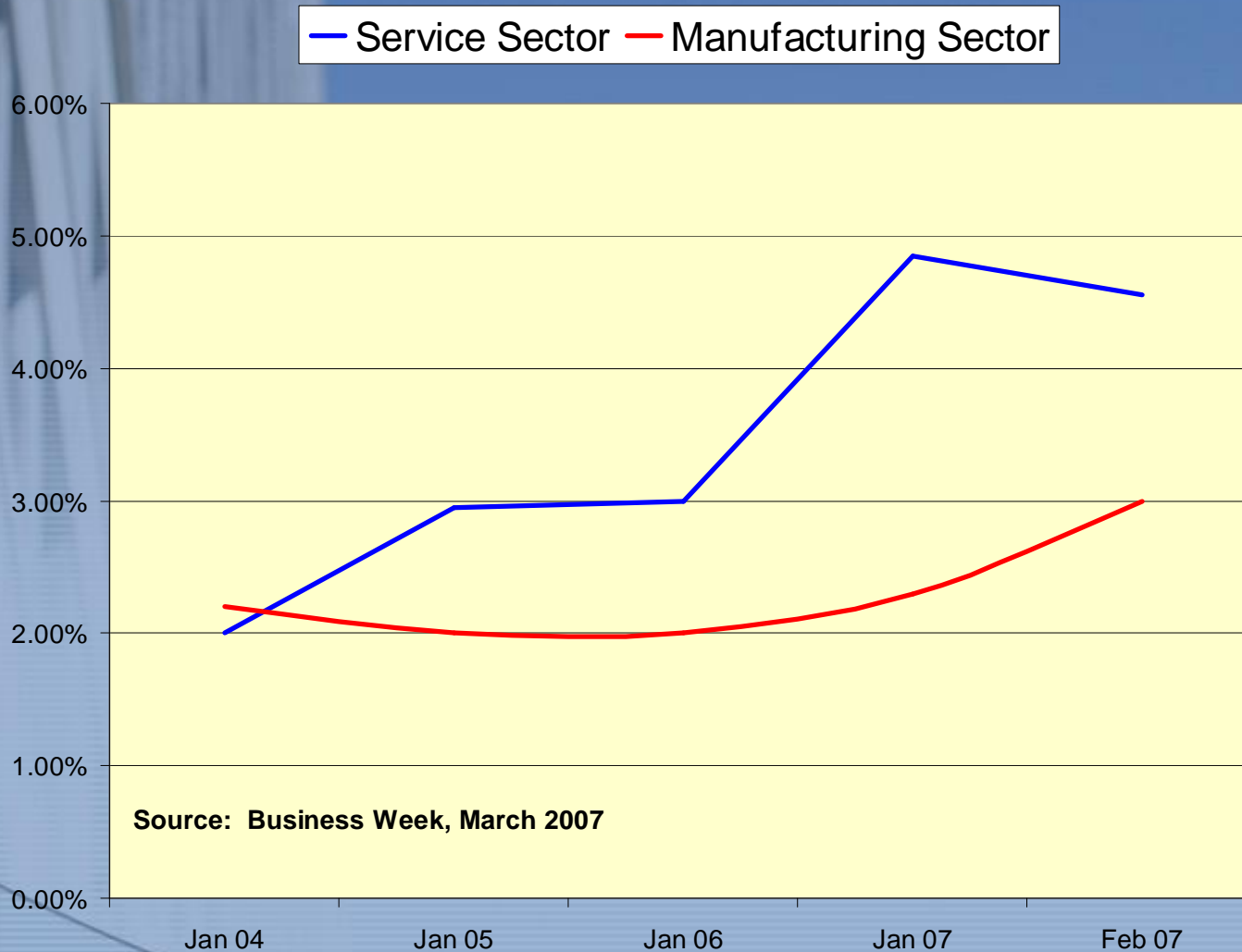
# Gap Between Labor Costs and Take Home Pay

Single Person Without Children on Average Earnings  
Source: OECD, The Economist (data from 2005)



You are looking at the tax wedge--the gap between what employers pay for labor and employees take home as pay. The wedge is made up of income taxes and the social security contributions of both firms and workers. The bigger the wedge, the greater are the barriers to job creation.

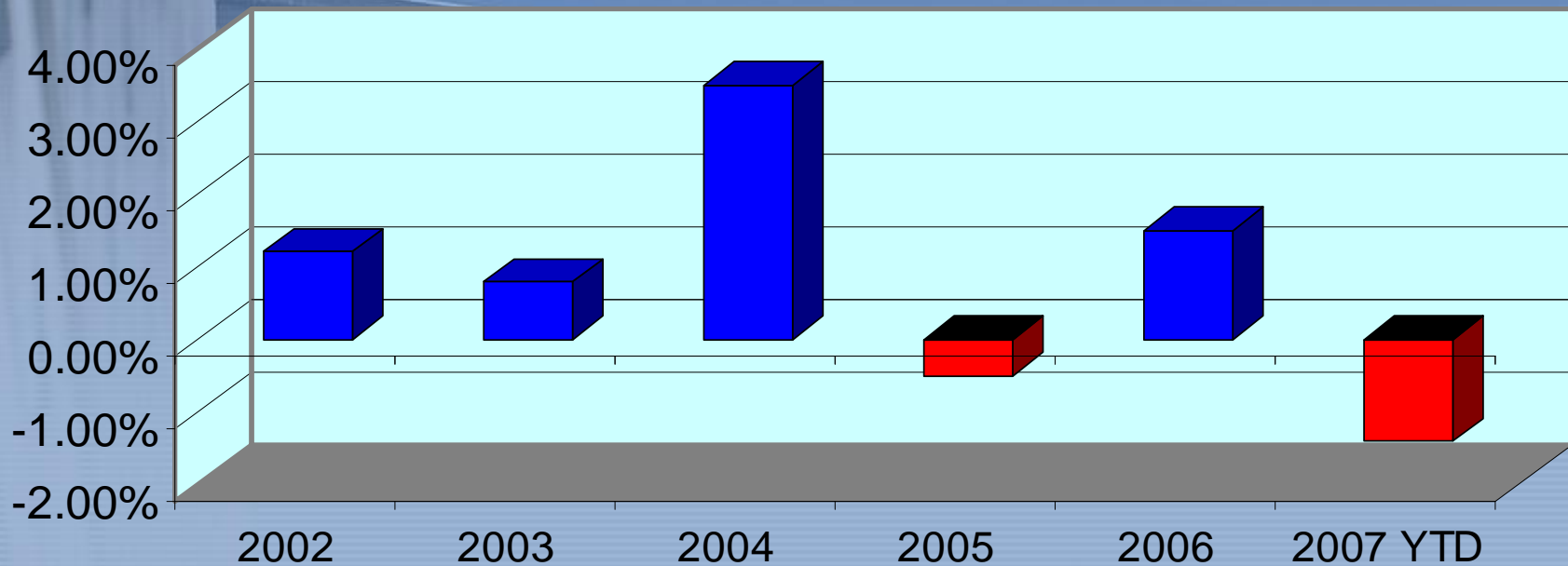
# Service Sector Leading Growth in Pay



**The jobless rate fell to 4.4% in March because of service sector strength. Household net worth—assets minus liabilities—rose to a record \$55.6 billion in 4Q 2006. As a percentage of after tax income, it stood at its highest level in more than six years. Given tight labor markets and a speed up in exports, consumers should continue to make their way to shopping malls with little let up.**

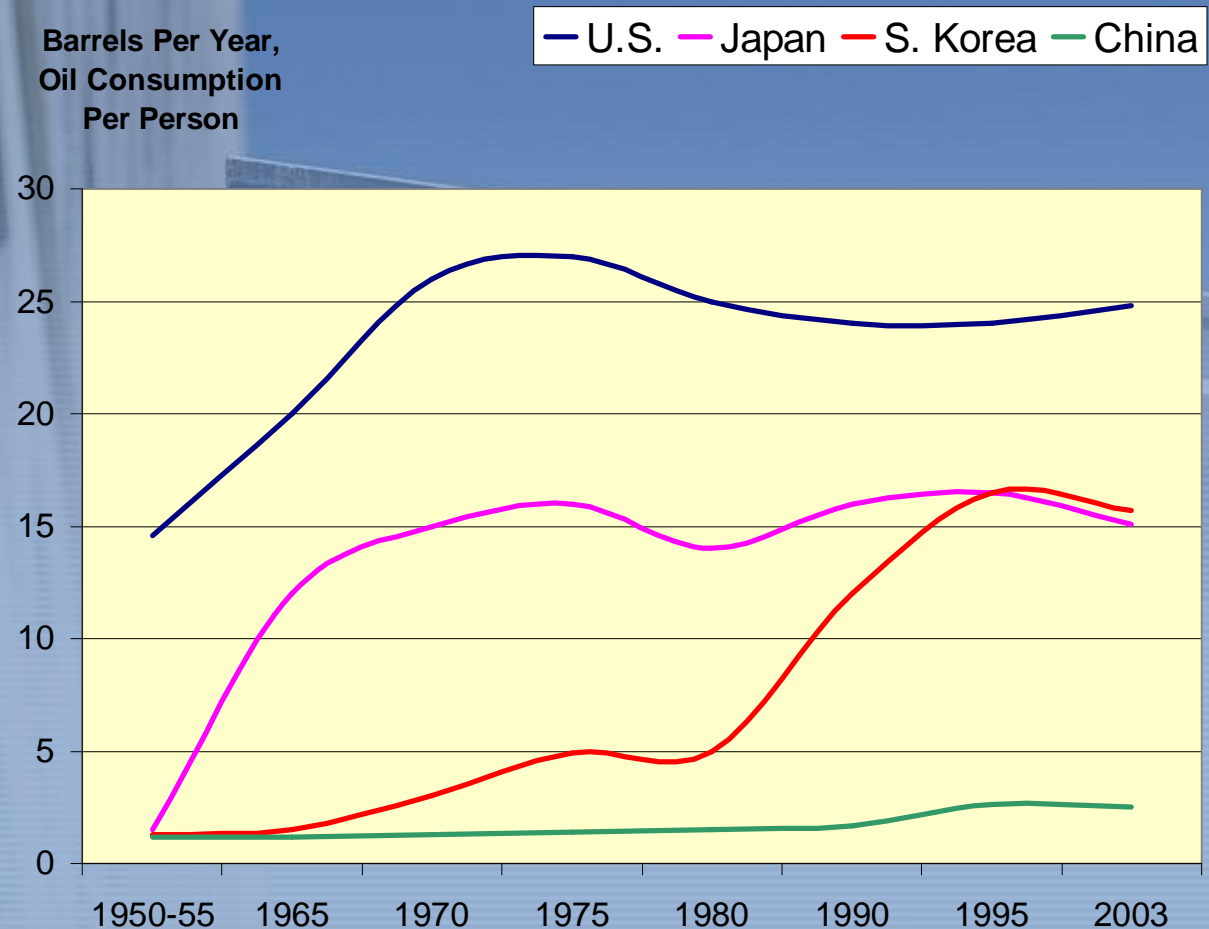


# Global Inventory Growth



Source: Business Week, March 26, 2007

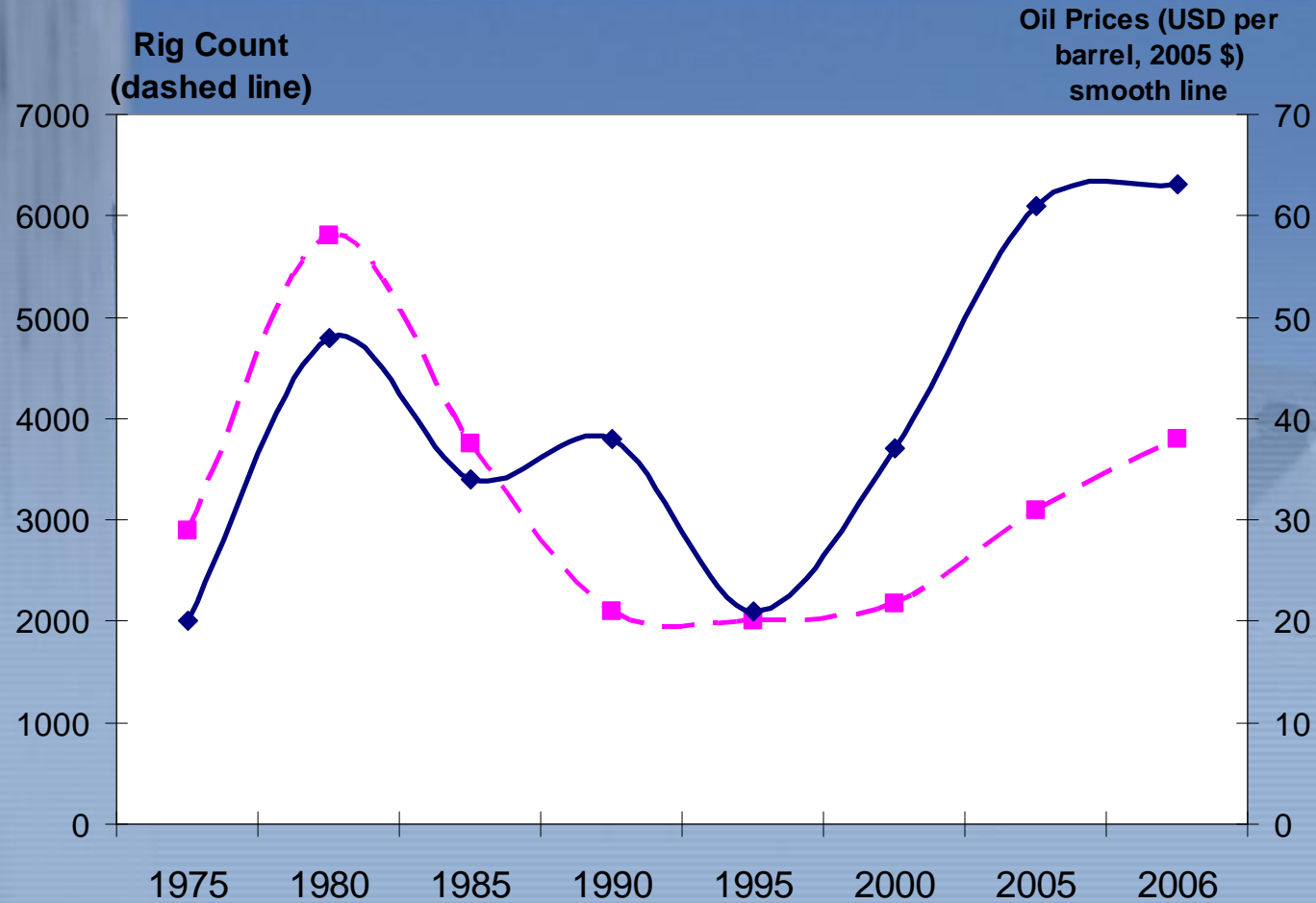
# Oil: \$60 to \$70 a Barrel



This chart from The Economist shows...

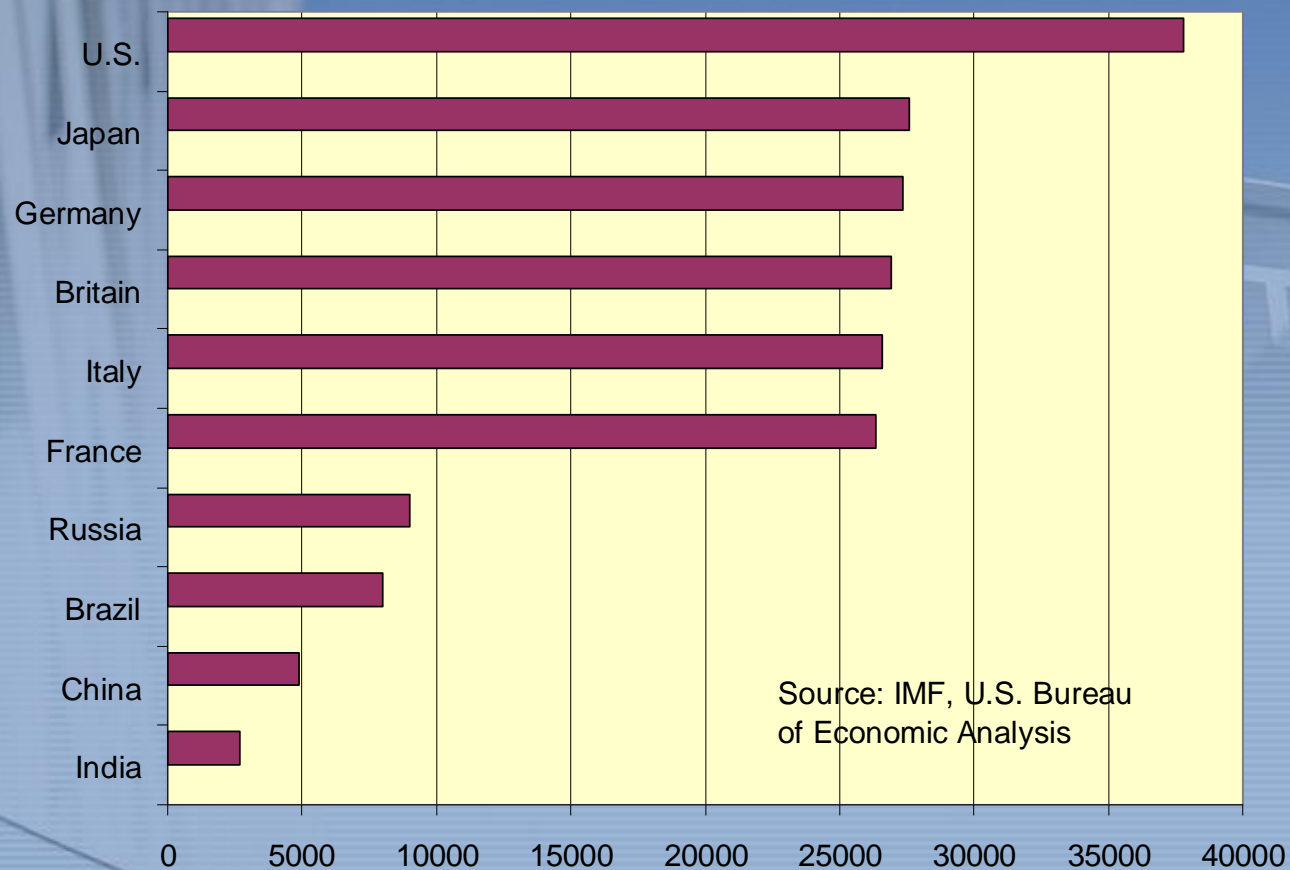
- \$60-\$70 a barrel oil is a much bigger threat to the U.S. economy than to other economies.
- The U.S. economy remains extraordinarily energy-intensive.
- This is a major reason our government is pushing for a move to alternative energy.
- It may also be a reason our Congress is pushing the Kyoto Agreements. It would make crude oil so expensive that alternative energy would become a bargain at \$4.50 to \$5.00 a gallon (at the pump).

# Real Oil Prices and Worldwide Rig Count



# The Giants of the World Economy

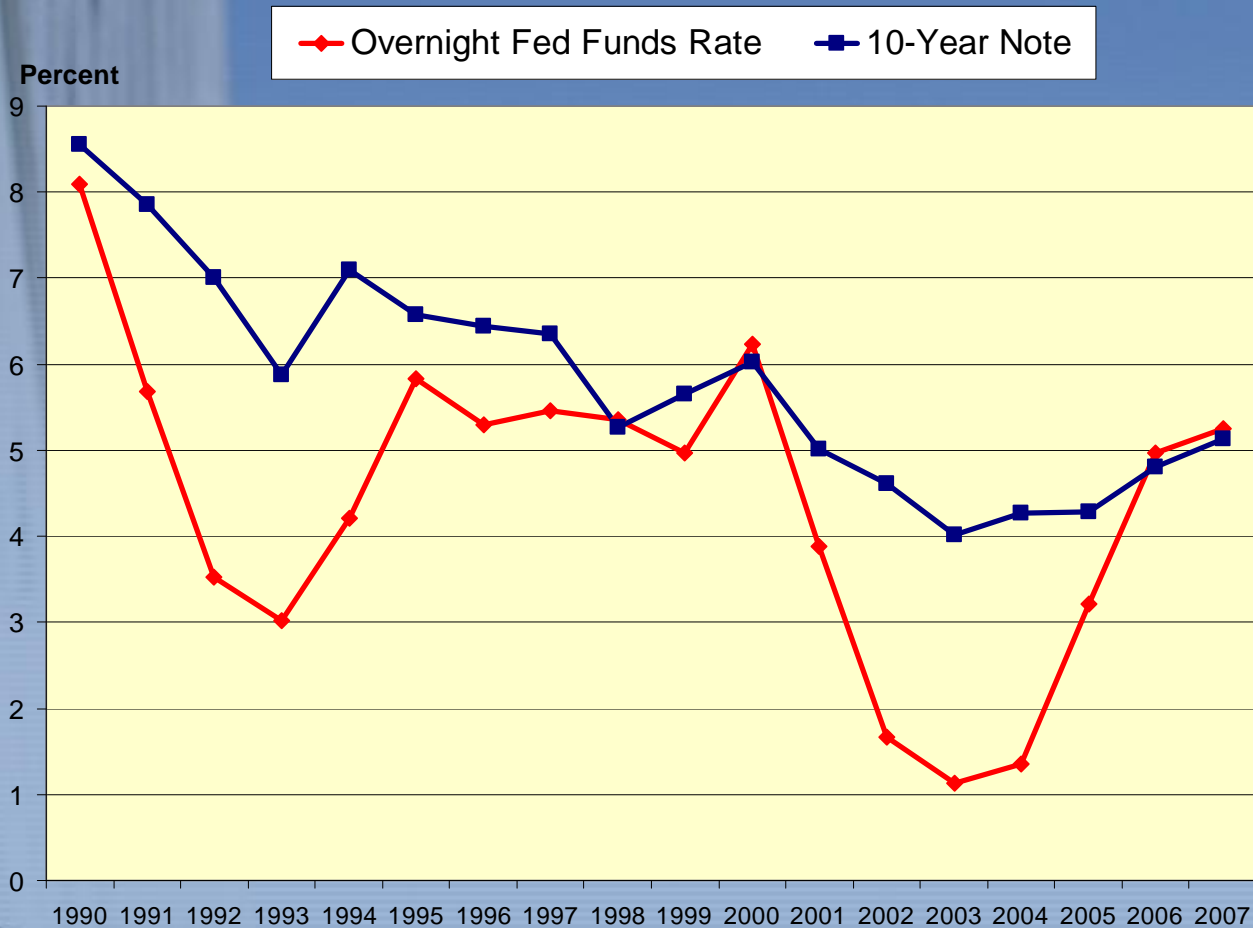
GDP at Purchasing Power Parity, 2003, \$ in Trillions



- **At current exchange rates, China is only 1/3 the size and India 1/5 the size at purchasing power parities.**
- **But if you project China and India forward, the current OECD has only one more generation of economic predominance at most.**

# U.S. Monetary Policy Since 1990

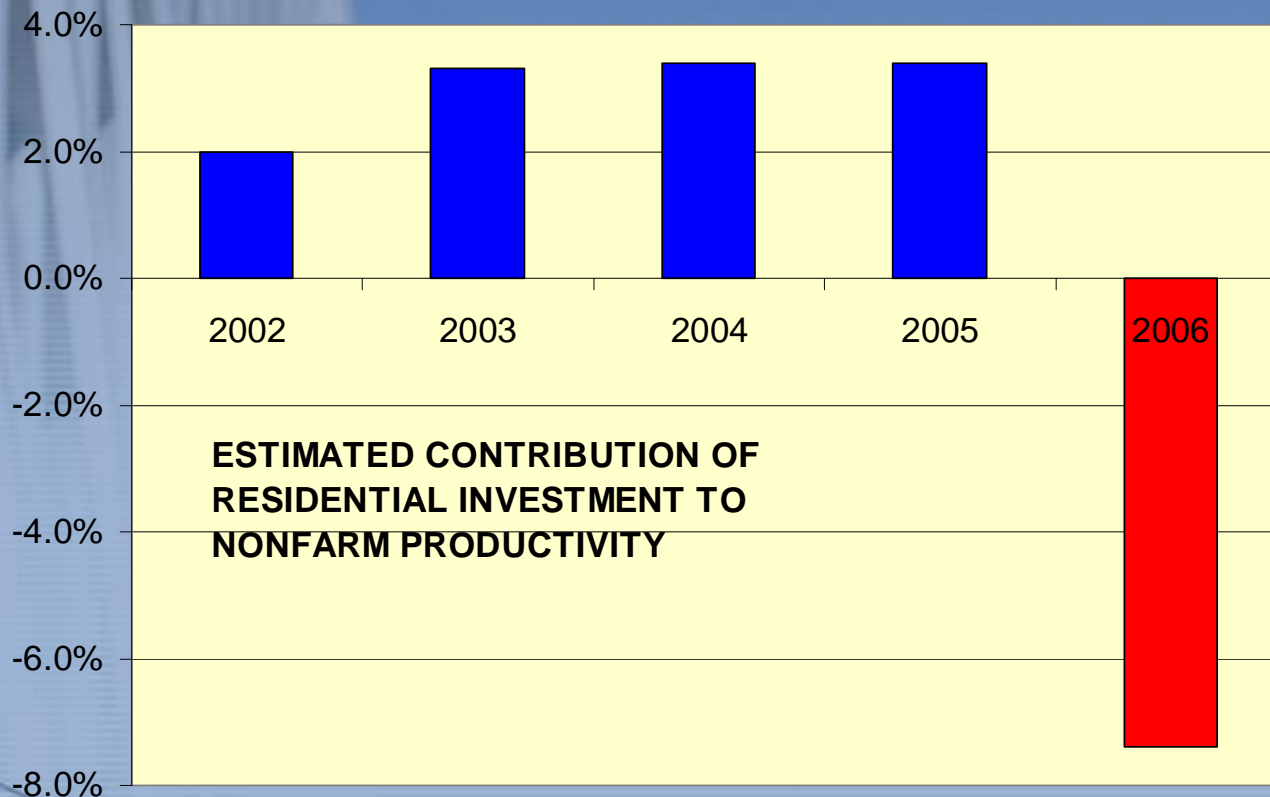
Source: Federal Reserve Board



- Since 1990, the Fed has moved aggressively to try to maximize employment and purchasing power.
  - Recession of 1991
  - New economy of 1997
  - Crisis of 1998
  - Recession of 2001
- Now the Fed is beginning a tightening cycle.
  - It thinks interest rates have been too loose for too long.
- The shape of the recovery says that they are right—or at least half right.

# Productivity Down But Not Out

Productivity Down But Not Out  
Source: Citigroup, Business Week

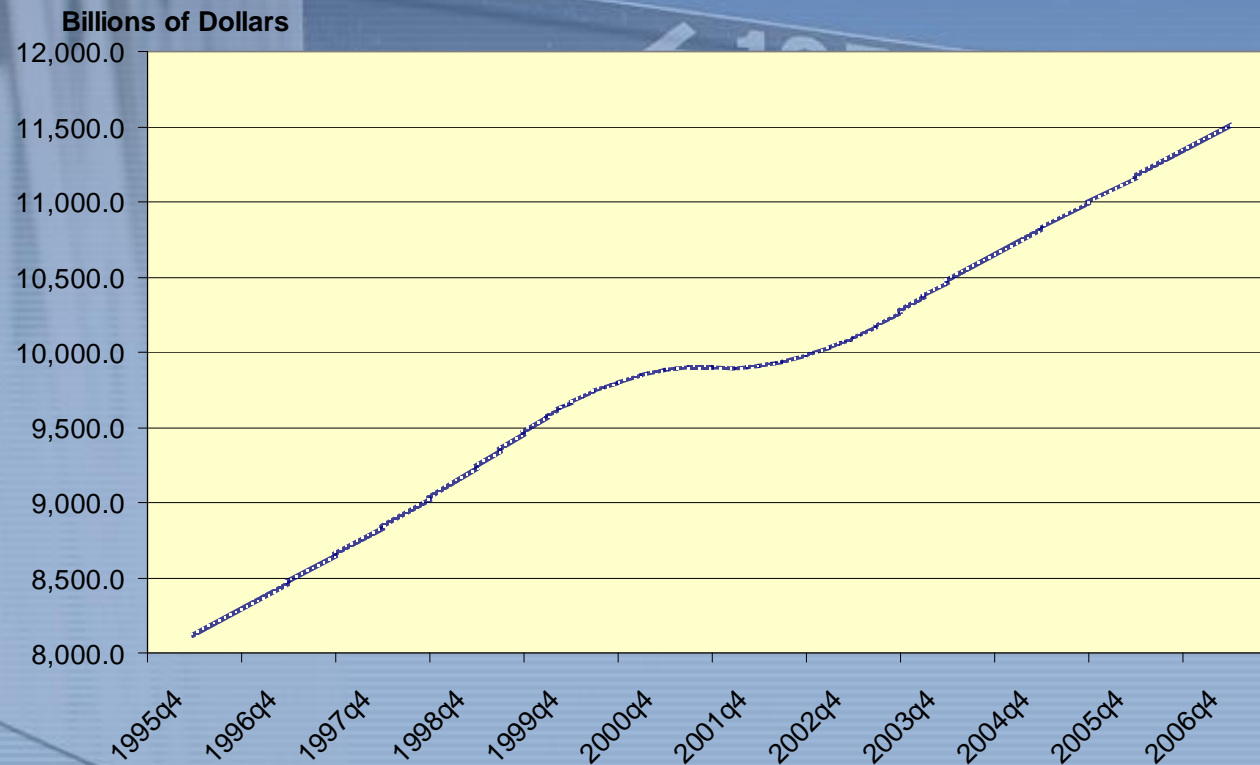


- **During 2006, productivity was the weakest in nine years.**
- **The cost of producing a unit of goods soared.**
- **Investment in residential construction plunged in 4Q 2006 by 19.2%, the biggest decline since 1991.**
- **Once the imbalance in the data corrects, productivity should return to its 2005 levels.**

# The U.S. Recovery-Real GDP

U.S. Real GDP, 1995-2006

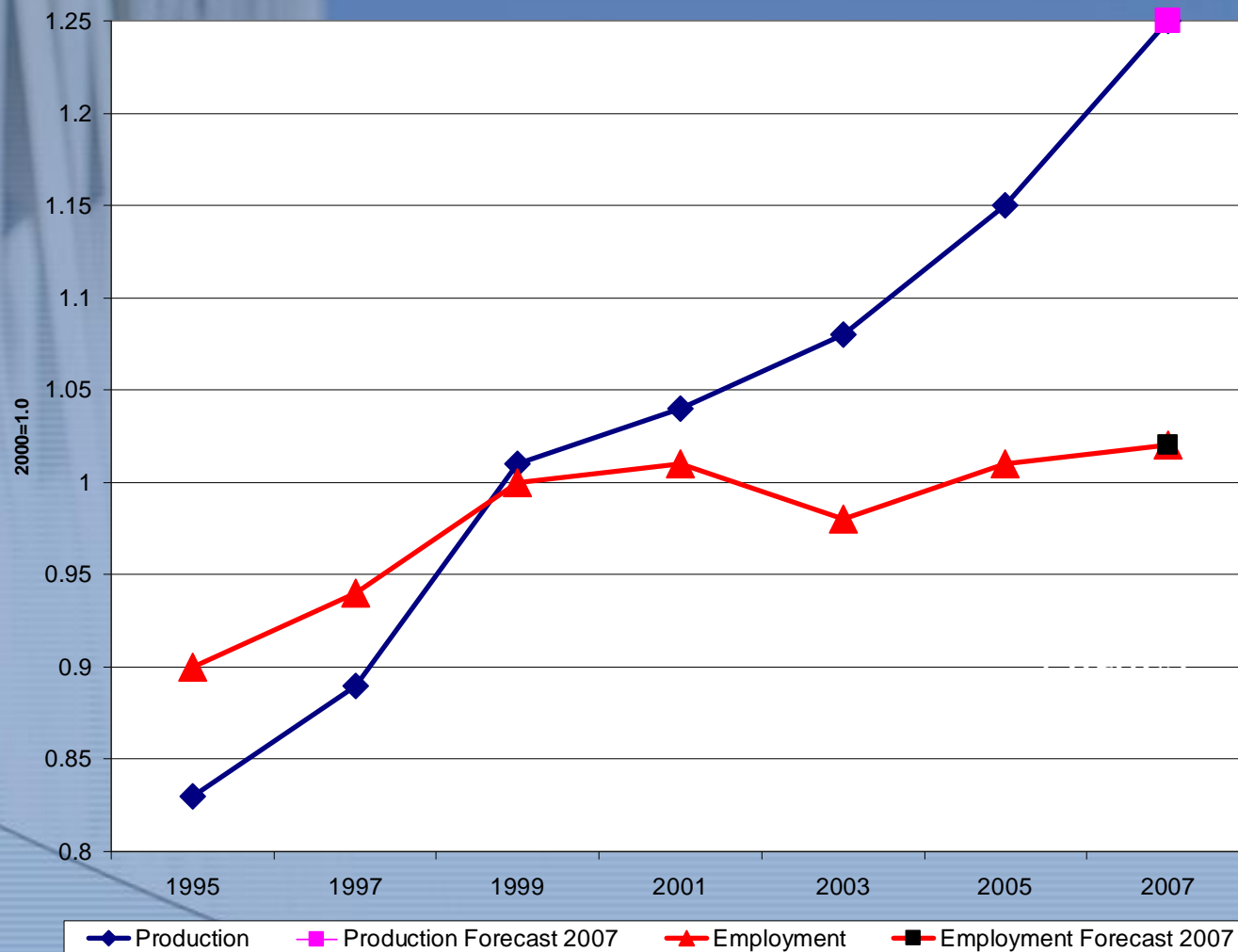
Source: Bureau of Economic Analysis  
GDP in Billions of Chained 2000 Dollars, Q4



- After a year of effective stagnation, and another year of slow growth, the past three years have seen American real GDP grow at a healthy pace.
- In percentage terms, real GDP growth has not been as fast as in the boom years of the late 1990s.
- But compared to the pace of growth during the 1973-95 productivity slowdown, it is very gratifying to see indeed.



# The U.S. Recovery—Myth or Fact?



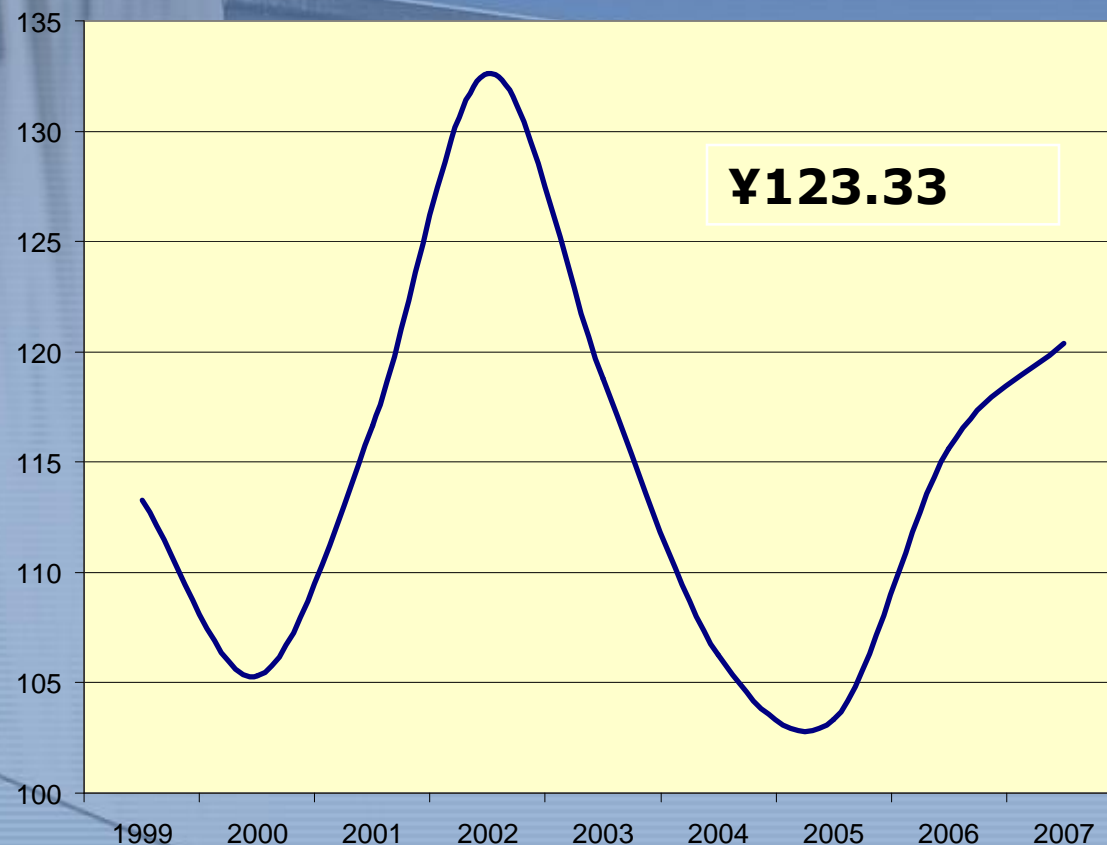
- Forecast 2.5% GDP 2007-2008 as dollar moves lower, then GDP higher
- Unemployment to move a bit lower unless dollar moves higher
- Bias is towards higher interest rates unless dollar moves lower
- Stable unemployment numbers mean milder inflation, but weaker dollar, lower productivity would cause the opposite

# Stock Prices Rise on Lack of Supply



# The Coming Decline in the Dollar

Yen-Dollar Exchange Rate  
January to January, Yearly  
Source: X-Rates.com



- At the moment, it is convenient for the U.S. government to delay the closing of the trade deficit (to benefit from the capital inflow).
- At the moment, it is convenient for others to delay the closing as well (to benefit from the demand for their exports).
- It will not always be convenient...
- And markets will try to jump in advance (discount) and so accelerate the forthcoming (30%) decline in the dollar.

# Political Dangers to Free Trade

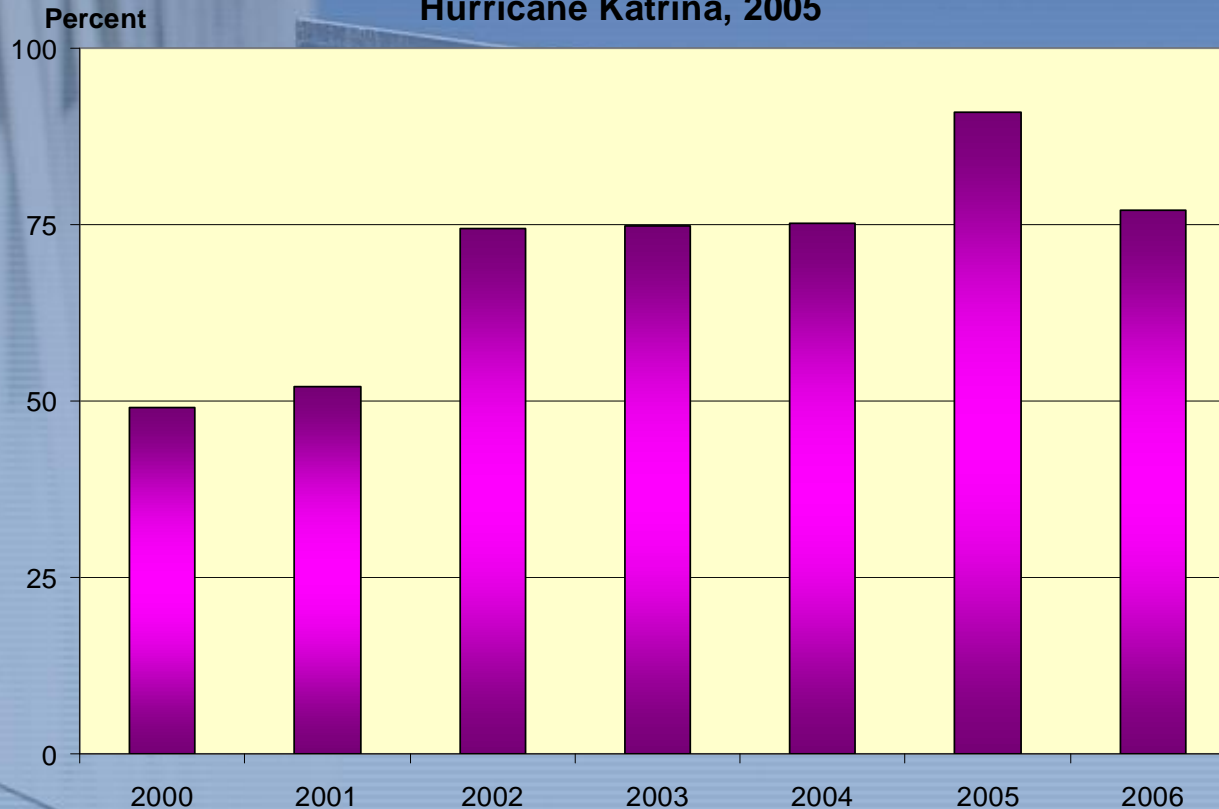
- American politicians and businessmen have been complaining most loudly about China stealing their country's jobs.
- American politicians do not understand the division of labor within Asia: other countries now ship capital-intensive components to China for labor-intensive processing and assembly, to be re-exported to developed countries. China imports motherboards and memory chips and exports computers.
- Mexico is under heavy pressure from China...
- Pam Woodall of the Economist reports that "foreign multinationals' subsidiaries or joint ventures in China have accounted for two-thirds of the increase in China's exports...(T)he explosion in those exports has more to do with foreign firms relocating their production to China than with Chinese businesses undercutting other producers."
- China is trying to move up the value chain to higher-value, high-tech goods, but so far without much success.
- Remember comparative advantage: China cannot make everything!

# Two Asset Booms

- Pam Woodall of the Economist writes:
  - The NASDAQ boom created \$7 trillion over four years, equivalent to almost two years' income from employment.
  - The housing boom has created \$5 trillion.
  - This new wealth is an illusion: rising house prices merely redistribute wealth to homeowners from non-homeowners who hope to buy in the future.
- Kenneth Coleman's comment
  - Now that the real estate correction is pushing housing costs lower in most parts of the country, rents are also coming down. The ball is starting to move back to the non-homeowners' court.

# Our Nation's Dependence on Foreign Money Increases

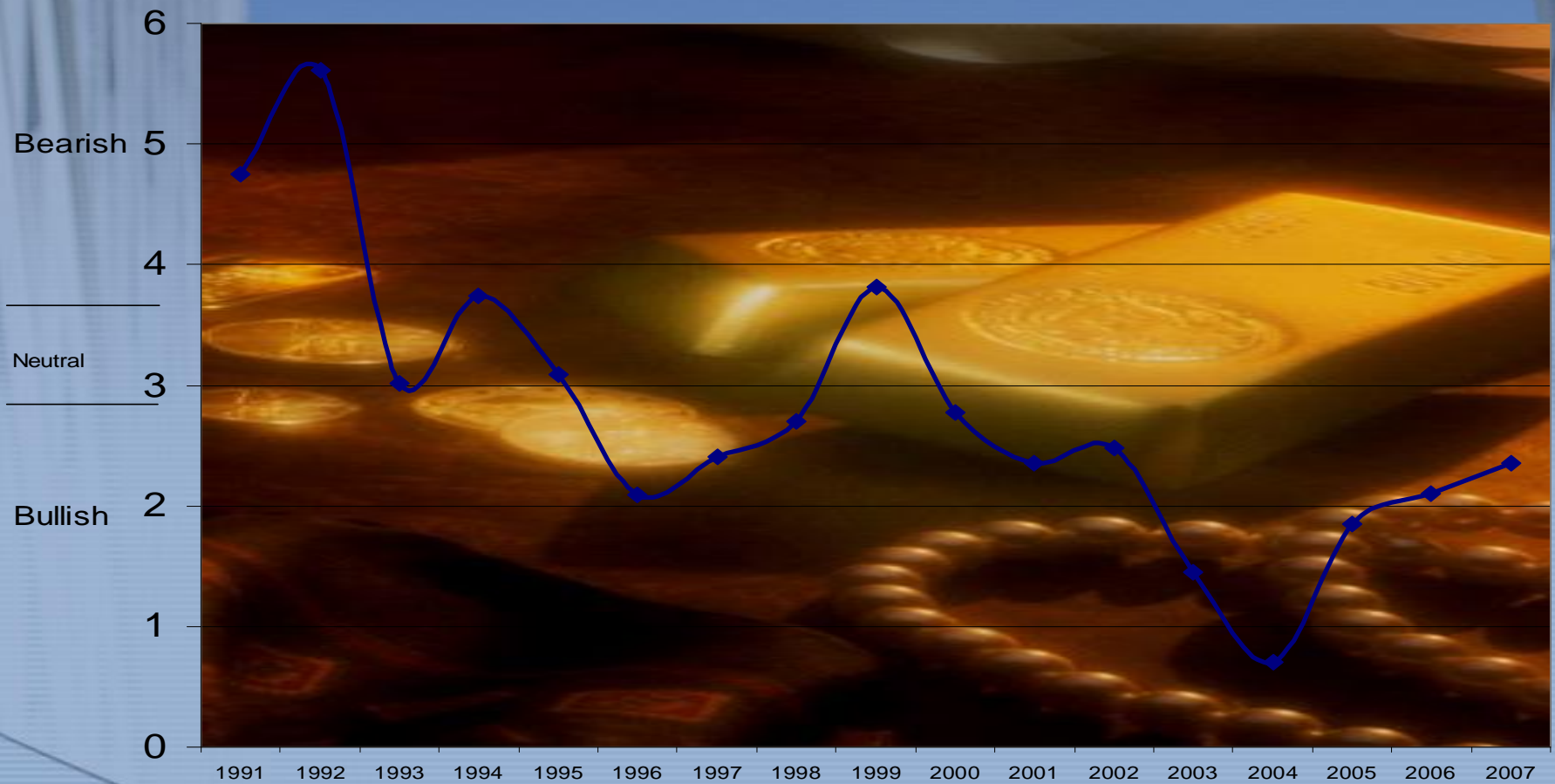
**Foreign Lending as a Share of U.S. Net Domestic Investment**  
Source: Bureau of Economic Analysis, Global Insight,  
Business Week  
Hurricane Katrina, 2005



- Domestic investors find the interest rates on our Treasury notes and bonds too low considering potential dollar weakness and price inflation.
- That is why our nation must depend on foreigners to buy our debt.
- The need for foreign investment in the first quarter of 2007 is on course to be higher than 2006.



# Gold Money Flow Index





# My Portfolio Records

- 1999 Portfolio (Blanchard) +129%
- 2000 Portfolio (Blanchard) +201%
- 2001 Portfolio (AAII) +14.72%
- 2002 Portfolio (AAII) +17.20%
- 2003 Portfolio +137.78%
- 2004 Portfolio +27.27%
- 2005 Portfolio +21.88%
- 2006 Portfolio +38.76%
- 2007 (YTD) +7.05%



# My Portfolio Records

Kenneth Coleman's 2004 Portfolio

Stock/Symbol	Short-Term Investment Phase	Shares Owned	Purchase Price	Market Price 3/4/2005	Change	Total Invested	Current Value	\$ Gain (Loss)	% Gain -Loss
Annico Eagle Mines/AEM	4-Hold	100	16.18	14.55	-1.63	1,618.00	1,455.00	-163.00	-10.07%
Hanover Compressor/HC	4-Hold	200	11.50	13.31	1.81	2,300.00	2,662.00	362.00	15.74%
Silver Standard Res/SSRI	4-Hold	100	10.75	13.73	2.98	1,075.00	1,373.00	298.00	27.72%
Medtox Scientific/TOX	4-Hold	100	6.67	7.85	1.18	667.00	785.00	118.00	17.69%
Vasco Data Security/VDS	4-Hold	100	5.48	7.50	2.02	548.00	750.00	201.90	36.84%
Ventiv Health/VTIV	4-Hold	100	12.50	24.65	12.15	1,250.00	2,465.00	1,215.00	97.20%
<b>Totals</b>						<b>7,458.00</b>	<b>9,490.00</b>	<b>2,031.90</b>	<b>27.24%</b>
Cash Balance							<b>\$40,504.90</b>		
Total Portfolio							<b>\$49,994.00</b>		
Opening Cash Balance							<b>\$50,814.00</b>		















Kenneth Coleman's

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