



# MARKET OUTLOOK

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## Economic slowing prompts need for caution

After three years of very difficult market conditions, the current rally has many investors feeling better again. But as the New Year begins, investors need to keep a close watch for any changes in market behavior.

Beginning in 2004 and continuing through most of 2006, the Federal Reserve raised interest rates in an effort to slow the economy and stave off inflation. We are now seeing signs that Fed efforts are having an impact.

The cooling housing market throughout much of the country has been well documented. Now there are other, confirming indications of an economic slowdown.

The Commerce Department recently reported a 4.7% decline in factory orders in October, the third drop in four months and the biggest decline in more than six years.

In November, the Institute for Supply Management's index of manufacturing activity dipped below 50, a number that indicates a decline in manufacturing activity.

Another Commerce Department report showed a sharp slowdown in worker productivity in the third quarter of 2006. At the same time, wages and benefits grew at an annual rate of 2.3%, much slower than previously reported.

These and other reports present an image of an economy that is

cooling down and one where inflation poses no significant threat.

The new concern for investors needs to be whether the Federal Reserve will be successful in its objective to slow the economy without causing a recession. Historically, this is something the Fed has rarely achieved.

If a recession is coming, how soon will it arrive and when will the financial markets begin to react?

John Mauldin is a respected market analyst and economic guru. He is forecasting a recession in 2007. He wrote, "An inverted yield curve is the best indicator of a recession coming within at least four quarters. When we saw the yield curve invert in September of 2000, we had a recession about 7 months later. ...If we had the same timing, that would suggest a recession beginning in the second quarter of 2007."

The inverted yield curve he refers to is the difference between the yield rates on short-term and long-term bonds. The inversion occurs when the short-term bond yields are equal to or higher than long-term rates, a situation that exists right now.

Of course, pinpointing the exact beginning of a future recession is impossible. Perhaps the Federal Reserve will be successful in its quest to avoid a recession. But rest

assured that if Wall Street believes a recession is on the horizon, the stock market will correct significantly before it arrives.

If Mauldin's forecast is correct and a recession comes in the second quarter of 2007, then a market correction could occur sometime in the first quarter.

For now all of the major market indices are trending strongly upward. As long as that is the case, it makes sense to remain fully invested. But when fundamental and technical indicators show a reversal in market momentum, investors should be prepared to step aside.

Some of the technical indicators to watch for include:

- **Rising new lows**—When the number of news lows on the Nasdaq exceeds 70 for two consecutive sessions, or when the number on the NYSE tops 50 for two sessions, that is a fairly reliable indicator of market weakness.

- **Falling relative strength**— A change in market momentum is signaled when the relative strength index of major market indices drops below 50 and then trends below that mark.

- **Moving averages**—When the indices cross below a 50-day moving average that is a strong signal that market conditions are no longer favorable for a sustained

advance.

—*Flint Stephens*

## Don't be a victim of investment guru lies!

When you go collect your regular mail or open your email inbox, you undoubtedly receive solicitations from investment gurus promising to help you earn unbelievable profits. Usually these experts promise to reveal their secrets if you subscribe to their newsletter or their advisory service.

At various times over the past two decades, I worked for a few of these folks, and I think by revealing some of the secrets I learned, you might be able to save some hard-earned money.

I have a huge stack of these solicitations in my cabinet and for an example, I can virtually select one at random. That's because they all follow some pretty standard formulas.

The one I've pulled from the collection has a huge headline stating that a new oil and gas discovery will rewrite the energy story in 2004. As it turns out, energy was the top performing sector in 2004. Almost every investor who bought energy funds or energy stocks made nice profits dur-

ing the year. So this headline seems somewhat prophetic.

Here is the subhead, also on the front cover and repeated on page 3: "This stock—recently trading for less than \$2—could be the energy investor's best bet this year. It's sitting on up to \$1.5 billion in oil and natural gas in the ground, worth \$10 a share right now—and a whole lot more if just a few things fall into place."

At this point, you are no doubt salivating over the prospect of learning about this hot stock tip. But before I reveal the stock and its trading symbol, I'm going to let you in on the first investment guru secret.

### Secret #1—The Hook

These solicitations almost always start with a bold, promissory headline. This sample is actually fairly tame. Often they throw out some unbelievable number, like: "last year a single recommendation from this genius could have earned you 387%." The hook is designed to grab your attention by appealing to a base human emotion: greed.

When you turn the page of our sample solicitation, you see a personal letter from the guru, explaining why this company is such a fantastic, undiscovered investment value. In bold type, he proclaims: "Please accept this report as my gift to you."

What a great guy! He doesn't even know me, but he is offering me a free gift that can make me incredibly wealthy. This brings us to:

### Secret #2—The Package

In this case, the solicitation is designed to look like a special issue of an investment publication. On the front cover, it even states: "Special Issue—April '04."

The back cover looks like a table of contents with several more dramatic headings. Sometimes these offers are printed with a glossy, full-color format designed to look like a magazine. In the industry, they are called "magalogs." The objective is to create the idea that you have somehow been selected to receive something of value without paying anything for it.

The writing and graphic design is usually top notch, with plenty of color pictures, quote boxes, sidebars, charts and even maps. This example has a quote printed in red from former Federal Reserve Chairman Alan Greenspan on page 4. It states: "Today's tight natural gas markets have been a long time in coming, and futures prices suggest that we are not apt to return to earlier periods of relative abundance and low prices anytime soon."

This is an example of:

### Secret #3—Testimonials and endorsements

These can be actual testimonials from people claiming to have made money by heeding the expert's advice. Normally, though, they are pseudo testimonials like the quote from Greenspan. It's not an endorsement of the product, but rather of the concept.

In this case, it helps lend credibility to the argument that 2004 is going to be the start of a fabulous period for energy investors. After all, among investors, probably no one engenders more trust than Greenspan. Fortunately, Greenspan speaks often and on a wide range of

## Important Investor Information:

Past performance may not be indicative of future results. Therefore, no current or prospective client should assume that future performance of any specific Strategis strategy will be profitable or reach its performance objective. Different types of investments involve varying degrees of risk, and there can be no assurance that any specific investment or strategy will be either suitable or profitable for a specific investment portfolio. Certain portions of this newsletter contain a discussion of various positions and beliefs as to current and anticipated market conditions, which are based upon professional judgment. However, there can be no assurance that any such position or belief will prove to be correct. In addition, due to various factors, including changing market conditions, such discussion may no longer be reflective of current position(s) and/or belief(s). Finally, no reader should assume that any such discussion serves as a substitute for personalized advice from Strategis or any other investment professional. Securities offered through Brecek & Young Advisors Inc., a Registered Investment Advisor/Broker Dealer

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subjects, so it's fairly easy to find a comment supportive of a given economic viewpoint.

This solicitation also includes a notice that the newsletter being offered has been ranked #1 by an impartial financial ranking firm. I could devote this entire issue to explaining the complexities involved in these ranking systems and most of us still would not be able to understand it. Let's just say that newsletter rankings don't necessarily correlate to profits in your investment account.

Finally, there is a short biography of the author, listing his many credentials and appearances.

This solicitation includes 20 pages. Much of the inside content is devoted to:

### **Secret #4—The Sell**

The sell includes descriptions of several previous investment recommendations by this expert that turned out to be big winners.

Any investment newsletter writer who wants to list some recommendations that returned big profits should have plenty from which to choose.

Consider this. If a guru publishes 12 issues a year and makes 15 recommendations each time, that totals 180 recommendations in a year. If he has been publishing a newsletter for 10 years, that's 1,800 recommendations. Relying on nothing but luck, there should be many hefty gainers.

In addition to touting past winners, the sell usually includes a folksy story about the guru. There is an "aw shucks" explanation about how he is just really just an ordinary guy and is definitely not part of the Wall Street insider's club that is only interested in stealing from small investors. In fact, he wants to impart his secret information to ordinary investors so they can make the same kinds of obscene profits as those greedy, heartless New York brokers.

The sell also includes plenty of verbiage explaining why this particular recommendation is bound to be a winner. In this example, it details numerous reasons why 2004 should

turn out to be a banner year for energy stocks. When teaching me how to handle this aspect of the marketing pitch, one of my former mentors said, "the more you write, the more they bite." He meant that volume can be mistaken for substance. The more information one includes, the more likely it is that a potential subscriber will decide your argument makes sense.

If someone makes it through the sell, they are presented with:

### **Secret #5—The Offer**

The offer is always at the end of the solicitation and it comes in two forms. The offer is usually first mentioned in the body of the text. The guru tells the price, then explains that he is giving you a special rate because of your good taste, your intelligence, your good looks, etc.

Usually the special price will be about 50% off of the regular price. And if you sign up for a second term right off the bat, there will be an even greater discount. As if that weren't enough, he is also going to give you some free special reports when you subscribe. These will have titillating titles like:

- **7 unknown stocks that could make you rich this year!**
- **5 secrets to bigger profits that your broker doesn't want you to know!**
- **You can get rich by avoiding an impending economic train wreck!**

And if you double the subscription term length, you will get additional free reports. But some people will still hesitate. To entice those fence sitters, the offer will include a special free bonus if you respond within 10 days. The truth is, they have no idea whether someone is responding within 10 days or not. It is just one more gimmick thrown in to help seal the deal. It's like the set of glistening steak knives thrown in at the end of an infomercial.

The entire offer is restated again on an order form, usually the last page. But because some people remain undecided, they resort to:

### **Secret #6—The No-Risk Guarantee**

Because this down-to-earth, ordinary guy/investment guru's only wish is to make you rich and happy, he promises to send back all your money if you aren't thrilled. And if you decide to cancel, you get to keep the free special reports. How could anyone resist? Actually, about 99% of the people who receive these offers do resist. But if just 1% end up as subscribers, the guru will be on the way to securing his retirement.

### **The Secret Stock**

Now that you've read this far, it is time to reveal the energy stock that "could be the investor's best friend." With record energy prices, virtually every energy stock had a banner year in 2004. Surely a gem like this one outperformed most of its peers. The name of the company hyped by this expert is Silver Star Energy, Inc. Its trading symbol is SVSE. The accompanying chart below shows its performance.

Notice that the stock peaked at slightly over \$2 a share just before the date printed on the solicitation. It traded for a time at about 75 cents a share, but it fell below 50 cents at one point. So someone who bought the stock at \$1.50 saw his investment decline by about 66% during one of the strongest rallies ever in energy. If that same investor held until the end of the period shown in this chart, he was still down about 50%.

Notice that this stock was essentially non-existent six months prior to this expert's solicitation. So why would someone who is supposedly a respected investment guru recommend a stock with virtually no track record?

## The Real Secret These Gurus Don't Want You to Know

The answer can be found on page 14 in tiny print at the bottom of the page with a heading of "disclaimer."

There is all the normal legal gobbledegook you expect to find with any securities disclaimer. But there are a couple of lines that are a little different: "\_\_\_\_\_ expects to generate new subscriber revenue, the amount of which is unknown at this time, to its newsletter through the distribution of this special report. **Compensation associated with distribution to possible new subscribers including printing and postage in the amount of \$500,010 was paid for by \_\_\_\_\_ as an effort to build investor awareness to Silver Star Energy, Inc.**"

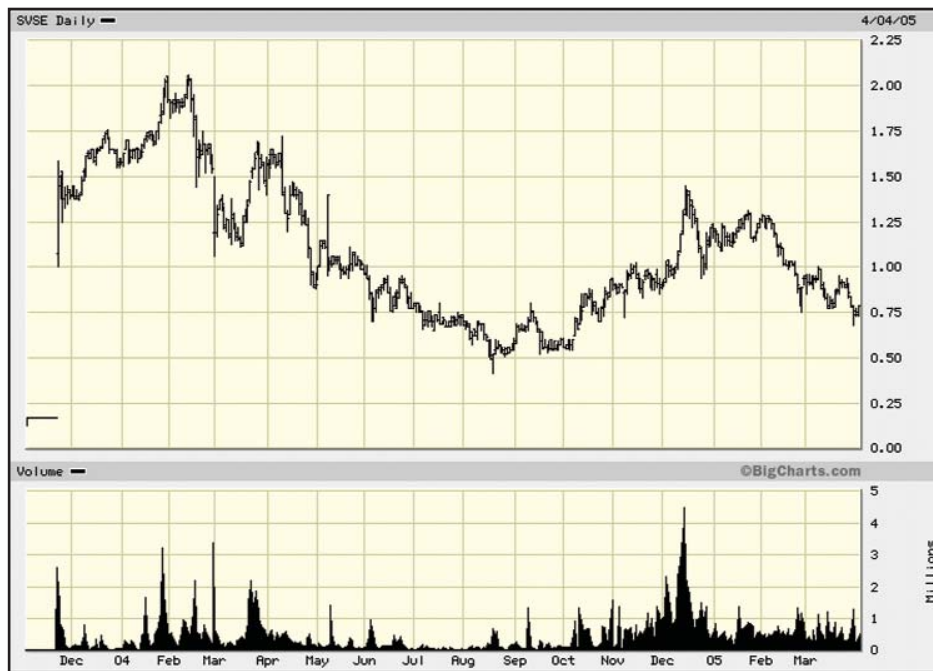
So why would someone who is supposedly a respected investment guru recommend a stock with virtually no track record? I can give you more than a half million reasons.

Of course, the actual reward for the publisher is likely much higher. Let's suppose our guru used that money to send out 600,000 solicitations. If he gets a 1% response and each of those people pays \$99 for a one-year subscription, that's an additional \$594,000.

If someone is unscrupulous, there are other ways to make money in this type of situation. For example, someone who knew in advance that a massive mailing promoting a specific stock was about to be sent out could buy shares of the stock beforehand, anticipating a run-up in the price. Then he could short the stock near its peak, anticipating the correction that would follow. In the old days, brokers called these types of schemes a "pump and dump." They would talk up a stock to get the price to go up and then they would start shorting at the top, so they made money in both directions. As mentioned previously, the example cited here is not unique. I literally have dozens of similar promotions I could have used.

## The Secret to Protecting Yourself

It's fairly easy to avoid being



taken in by these scam artists. When you get one of those promotions with the glossy picture and the headline that promises to make you rich, throw it away or delete it from your email. No matter how good it sounds, don't sign up, because it is a sucker's game.

There are some legitimate investment newsletters that provide valuable information. But they generally don't make outrageous claims and they don't promise to tell you insider secrets, because there aren't any.

Remember all of those sayings your mother taught you?

- If it sounds too good to be true, it probably is.
- There is no such thing as a free lunch.
- Read the fine print before you invest.

Actually, your mom probably never mentioned the last one, but it is still solid advice.

Thanks to the Internet there is a wealth of free information available to investors. There are many very good investment newsletters written by real market experts that won't cost you a penny. Some of my favorites (besides this one, of course) include:

- John Mauldin's weekly eletter, [www.frontlinethoughts.com](http://www.frontlinethoughts.com)

- Toby Smith's weekly eletter, [www.changewave.com](http://www.changewave.com)
- Several letters from Motley Fool, [www.fool.com](http://www.fool.com).

There are many others that could be listed. Suffice it to say, there is so much free information available that it doesn't make sense for most investors to pay to subscribe to questionable investment services.

One final word of advice. Be very cautious about making buys or sells based on information from these sources or any other. The people who write this information, including me, know nothing about your specific, individual financial situation. Their recommendation might be totally inappropriate for your risk tolerance or objectives.

*Flint Stephens is the marketing director for Strategis Financial Group. He has a master's degree in communications from Brigham Young University. He has written and edited many investment newsletters.*