

PORTFOLIO IMPLICATIONS FROM THE MAY 2005 FORECAST

JUNE 2005



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I am going to start with a caveat emptor. This is not investment advice, just what logically follows the rationale of my forecast. You can't sue me if you lose money as I am sure you wouldn't share the gains with me anyway!

1. Go long on Euro-denominated bonds relative to US long-term bonds.

This is a play on the fact that European growth prospects are dimmer than that of the US. This means that ECB is less likely to be as aggressive as the FED. Also, as short-term rates rise in the US, the Asian Central Banks will be tempted to hold more of their trade surpluses in short-term treasuries. They will still buy the 10-year bond but will shift the asset portfolio in favor of shorter maturities.

2. Oil stocks, especially exploration companies and emerging economy bonds (read Russia, Chile and South Africa), make for a pair.

Surprised, aren't you. Oil stocks work from a dividend payout perspective. With oil expected to remain above \$40 for a while, emerging economy revenues will be good as they tend to perform well when commodity prices are rising.

3. Non-energy large caps such as GE, Microsoft, Caterpillar, etc. are good buys.

Now, don't go betting your ranch on these three. But I like them and companies like

these are international in their market reach. Plus, they pay handsome dividends. What more do you want?

4. Drug companies are undervalued.

This is a simple one. Vioxx problems got not only Merck, but dragged the whole drug sector down with it. So how are we going to make the old people work so they don't need social security or health benefits? By making them as fit and mobile as a 25-year old, and to do that, we will need more new drugs.

5. Avoid consumer cyclicals but buy state, local and municipal bonds.

First let me expand the definition of cyclicals to include steel and cement. Why? Because as China slows down, one will find a glut of steel I will also add countries like Germany, Switzerland and Hong Kong on the avoidance list. Their consumers are in a state of depression that no amount of Prozac will lift. The result is deflation in not only asset prices but also in home values. I like the state, municipal and local bonds for their payment play, relative to treasuries. As the economy strengthens and coffers fill up at local and state levels, the supply of new bonds will decrease as more cash is on hand to finance projects. This will cause the demand to outstrip supply, making for handsome capital gains. It's definitely a better play than buying TIPS or any other long-term government bond.