As a subscriber of The Peter Dag Portfolio Strategy and Management you will be able to access on our website the following services.

1. Two issues every month of The Peter Dag Portfolio Strategy and Management.

2. One issue every month of The Global Business Cycle. This report shows the major business and financial trends of all major and developing economies.

3. One issue per month of The US economy. This presentation shows the major indicators of the US economy.

The following pages show you copies of these report.
Observations. I like to follow what is happening in Italy for several reasons. First of all, of course, it is the country where I spent a substantial part of my life. I understand what makes the Italians click and why. Although very creative, their economy is going nowhere.

They represent a great case study of how the political system of a nation can become so distorted to turn into a totally unmanageable economic system.

The little booklet by Fromm, bought years ago during one of my trips, made me think. I am not sure I agree with him when he suggests that the concept of property drives people to behave aggressively and basically ruins their life. He suggests we want to own and in the search of owning we fail to see what is exciting in life.

What triggered my interest, however, are his comments about what people seek. What do we want? What do we want to have to be happy?

One of the basic instincts is to achieve a sense of safety. To achieve a state that we can hang on to and feel safe because we are afraid of the unknown. Uncertainty makes us nervous. This is why we are concerned about new ideas. Because they change the status quo.

And we feel insecure because we lose our freedom, or so we think. What is our reaction? We ask the politicians to make the changes needed to make us feel more secure.

The Italians asked the politicians to make them feel comfortable and sheltered. And the politicians obliged. The price paid has been a massive bureaucracy sucking the lifeblood of the citizens. When one class becomes dominant, in any country, the price to be paid is stagnation. This is the price of security.

The dollar is sinking in a major way. It represents an incredible loss of purchasing power and reflects an overwhelming loss of competitiveness. Yet, the politicians are addressing our concerns and trying to make us feel secure (physically and psychologically).

No one, however, is even suggesting who and how we are going to pay for our security. As the bureaucracy becomes more dominant to provide us with what we want, the country will fall in an economic gridlock. The weak dollar and the Italians have something in common.

Portfolio Strategy

The stock market. In the issue of September 10 I placed the “You are here” arrow at the bottom of the cycle shown below. Since then the market has been strong and is making major strides.

12-MONTH STOCK MARKET CYCLE

Our technical indicators told us to buy in a very timely fashion. They have been rising gradually and steadily as the market strengthened. They are still well below the levels typically associated with an overbought market (more details after page 12).

How long will the market rise? The simple answer: as long as our proprietary indicator rises. The nice feature of this gauge is that it peaks several weeks ahead of the market. There is time to act (see after page 12).

The other answer is based on the seven month market cycle. The next bottom will take place around March with the market peaking in January-February.

The long-term trend of the market remains up with interest rates being favorable.

Seasonality is also positive and investors’ optimism has not yet reached the extreme levels typically associated with a market top.

Outlook. I moved the “You are here” arrow closer to the top to reflect a rising market moving steadily toward the next peak. The dominating sectors remain technology, hard assets, and international.
The US economy. Are we in trouble? Mr. Greenspan and Bill Gross seem to think so. Well, I am not convinced about the demise of the US economy.

The money supply is growing rapidly, the yield curve is steepening, and the stock market is rising. This is not what you see when the economy is in trouble. These are solid indicators pointing to a stronger economy.

Unemployment claims have dropped sharply and backlogs are soaring. This is good news for manufacturing and employment.

The housing sector is in shambles. The problem will be with us for several years. Bottom line: economic conditions are not as bad as reported.

Inflation. Inflation, if you believe the data released by the various agencies, is under control. Consumer prices are up only 2.0% y/y, producer prices up 2.1% y/y, and the broad PCE price index rose only 1.8% y/y.

This level of inflation gives room to the Fed to lower interest rates further.

The Fed. The rate on 13-week Treasury bills keeps sagging. The rate on 90-day prime commercial paper also dropped close to 5% in response to the increase in liquidity.

What does it mean? For the time being the markets are saying conditions reflect less uncertainty and risk. Are we out of the woods? No. Economic slowdowns always uncover the excesses of the previous upswing. This time is no exception. And the markets like it. Investors, meanwhile, are confused and do not know what to think.

Global trends. Global short-term interest rates have not declined as they did in the US. Either foreign economies are much stronger or they have problems not yet uncovered. Or a combination of both. Bond yields have stabilized. Foreign equity markets remain strong. The best performing ETFs are: FXI (China), EEB (BRICs), IFN (India), EEM (Emerging markets), INP (India), and EWH (Hong Kong).

Commodities. Commodities are strong.

Gold and the dollar. The weakness of the dollar is driving up the price of commodities and gold in particular. The odds favor further declines in the dollar according to our models. Bottom line: commodities and gold are more likely to rise than decline.

The yield curve. It keeps steepening. Good news!

High-grade bonds. I am lukewarm about Treasuries.

Low-grade bonds. They are attractive as the Fed adds liquidity to the banking system to cushion it from the subprime debacle.

Portfolio Management

Studying business trends is not a theoretical endeavor. There are solid reasons why corporations and financial institutions spend considerable sums of money to pay economists and strategists to dissect the economic data.

The objective is to understand what is happening and establish the possible economic scenarios. Probabilities are assigned to each scenario. The next step is to recognize the strongest stock sectors for each scenario. Then one selects the best stocks in each sector.

The challenge is to determine the outlook for the economy. In the current business cycle one can make the case that, because of the strength of the global economy (mostly Asia and Latin America), the business cycle will strengthen. Our leading indicators point to more strength ahead. A stronger economic is likely.

Another scenario, equally realistic, is an economic slowdown caused by the subprime fiasco and the weakness of the housing and auto sectors.

What should your strategy be? The strong economy strategy should emphasize technology (electronics, telecom, computer software and hardware, internet), metals and mining, and energy stocks.

The weak economy strategy should focus on financials, insurance, utilities, real estate, and defense.

What to do? I listen to the ultimate empire: the market itself. I gradually adjust the portfolio to what the markets are saying. And this is what they are suggesting to do right now.

Sell NRP and sell 2% of TLT.

Increase by 2% of your portfolio your investment in AXA.

Increase by 1% of your portfolio your investment in each of ASN, HME, and ETR.

The healthcare sector is strong and the specialized service sector is acting well. For this reason we recommend you add to your portfolio DaVita, Inc. (NYSE: DVA). DVA, provides dialysis services for patients suffering from chronic kidney failure. Recent price $63.94 @ 11:59 am ET, PE 18.37, yields n/a.

Invest 2% of your portfolio in DVA.

Bottom line. We have increased slightly our exposure to the “weak economy” sectors, and reduced the investment in the “strong economy” stocks.
### Dag’s Exclusive Picks

<table>
<thead>
<tr>
<th>Asset class (Allocation)</th>
<th>Company</th>
<th>Symbol</th>
<th>Industry</th>
<th>Date Purch'd</th>
<th>PE</th>
<th>Yield</th>
<th>Price Paid</th>
<th>Curr’t price</th>
<th>Change %</th>
<th>Amount %</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMMODITY DRIVEN 31%</td>
<td>Amerigas Partners</td>
<td>APU</td>
<td>Propane</td>
<td>14-Jul-03</td>
<td>15.8</td>
<td>9.60</td>
<td>26.70</td>
<td>35.85</td>
<td>34.27%</td>
<td>3%</td>
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<tr>
<td>BHP Billiton</td>
<td>BHP</td>
<td>Ind. Metals&amp;Mining</td>
<td>25-Jun-07</td>
<td>17.1</td>
<td>1.30</td>
<td>59.35</td>
<td>78.30</td>
<td>31.93%</td>
<td>5%</td>
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<td>Caterpillar</td>
<td>CAT</td>
<td>Machinary</td>
<td>23-Jul-07</td>
<td>15.9</td>
<td>1.80</td>
<td>86.39</td>
<td>78.13</td>
<td>-9.56%</td>
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<td>Core Labs</td>
<td>CLB</td>
<td>Oil &amp; Gas eq. svc.</td>
<td>23-Aug-07</td>
<td>31.4</td>
<td>n/a</td>
<td>102.91</td>
<td>126.04</td>
<td>22.48%</td>
<td>7%</td>
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<td>Danaher</td>
<td>DHR</td>
<td>Conglomerates</td>
<td>25-Jun-07</td>
<td>23.1</td>
<td>0.10</td>
<td>74.29</td>
<td>82.38</td>
<td>10.89%</td>
<td>7%</td>
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<td>Energy Transfer Partners</td>
<td>ETP</td>
<td>Propane</td>
<td>26-May-02</td>
<td>15.6</td>
<td>6.80</td>
<td>14.84</td>
<td>48.26</td>
<td>225.31%</td>
<td>3%</td>
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<td>Frontier Oil</td>
<td>FTO</td>
<td>Oil &amp; gas &amp; mkng</td>
<td>9-Jul-07</td>
<td>9.5</td>
<td>0.50</td>
<td>46.66</td>
<td>42.19</td>
<td>-9.58%</td>
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<td>Natural Resource Partners</td>
<td>NRP</td>
<td>Ind. Metals&amp;Mining</td>
<td>25-Jun-07</td>
<td>22.4</td>
<td>6.10</td>
<td>37.82</td>
<td>30.00</td>
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<td>Oil States Int'l.</td>
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<td>Oil &amp; Gas eq. svc.</td>
<td>9-Jul-07</td>
<td>12.1</td>
<td>n/a</td>
<td>44.23</td>
<td>48.85</td>
<td>10.45%</td>
<td>2%</td>
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<td>DEF &amp; AERO. 11%</td>
<td>Boeing</td>
<td>BA</td>
<td>9-Oct-06</td>
<td>22.4</td>
<td>1.30</td>
<td>83.95</td>
<td>104.35</td>
<td>24.30%</td>
<td>4%</td>
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<td></td>
<td>Goodrich Corp.</td>
<td>GR</td>
<td>26-Feb-07</td>
<td>20.7</td>
<td>1.20</td>
<td>51.72</td>
<td>68.81</td>
<td>33.04%</td>
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<td>REITs 6%</td>
<td>Archstone-Smith Trust</td>
<td>ASN</td>
<td>11-Sep-06</td>
<td>17.0</td>
<td>3.00</td>
<td>53.54</td>
<td>60.29</td>
<td>12.61%</td>
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<tr>
<td></td>
<td>Home Prptys of New York</td>
<td>HME</td>
<td>11-Feb-02</td>
<td>17.5</td>
<td>4.90</td>
<td>33.25</td>
<td>53.50</td>
<td>60.90%</td>
<td>2%</td>
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<td></td>
<td>ProLogis</td>
<td>PLD</td>
<td>24-Sep-07</td>
<td>15.9</td>
<td>2.70</td>
<td>65.93</td>
<td>68.82</td>
<td>4.38%</td>
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<td>UTILITIES 7%</td>
<td>ExelonCorp</td>
<td>EXC</td>
<td>16-Sep-03</td>
<td>26.5</td>
<td>2.30</td>
<td>22.40</td>
<td>239.14</td>
<td>29.24%</td>
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<td></td>
<td>Entergy Corporation</td>
<td>ETR</td>
<td>23-Oct-06</td>
<td>20.2</td>
<td>2.70</td>
<td>85.24</td>
<td>110.16</td>
<td>29.24%</td>
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<tr>
<td>HLTH CARE 4%</td>
<td>DaVita, Inc.</td>
<td>DVA</td>
<td>8-Oct-07</td>
<td>18.4</td>
<td>n/a</td>
<td>63.94</td>
<td>63.94</td>
<td>0.00%</td>
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<tr>
<td></td>
<td>Merck</td>
<td>MREK</td>
<td>24-Jul-06</td>
<td>23.8</td>
<td>2.90</td>
<td>37.32</td>
<td>52.28</td>
<td>40.09%</td>
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<tr>
<td>CONS. GDS 10%</td>
<td>British American Tobacco</td>
<td>BTI</td>
<td>16-Apr-07</td>
<td>17.9</td>
<td>2.10</td>
<td>63.15</td>
<td>70.15</td>
<td>11.08%</td>
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<td></td>
<td>Carolina Group</td>
<td>CG</td>
<td>16-Apr-07</td>
<td>17.7</td>
<td>2.20</td>
<td>78.59</td>
<td>85.53</td>
<td>8.83%</td>
<td>6%</td>
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<td>Imperial Tobacco Group</td>
<td>ITY</td>
<td>16-Apr-07</td>
<td>17.6</td>
<td>1.80</td>
<td>90.14</td>
<td>91.89</td>
<td>1.94%</td>
<td>1%</td>
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<tr>
<td>FINANCIALS 7%</td>
<td>AXX</td>
<td>AXA</td>
<td>22-Jan-07</td>
<td>12.1</td>
<td>2.70</td>
<td>41.92</td>
<td>45.34</td>
<td>8.16%</td>
<td>5%</td>
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<td>DB G10 Currencies Harvest</td>
<td>DBV</td>
<td>25-Jun-07</td>
<td>n/a</td>
<td>n/a</td>
<td>29.22</td>
<td>26.64</td>
<td>-1.98%</td>
<td>2%</td>
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<tr>
<td>TECH 19%</td>
<td>American Tower Corp.</td>
<td>AMT</td>
<td>13-Feb-06</td>
<td>770.2</td>
<td>n/a</td>
<td>31.47</td>
<td>42.69</td>
<td>35.65%</td>
<td>1%</td>
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<tr>
<td></td>
<td>Cypress Semiconductor</td>
<td>CY</td>
<td>10-Nov-07</td>
<td>14.5</td>
<td>n/a</td>
<td>26.08</td>
<td>30.00</td>
<td>15.03%</td>
<td>5%</td>
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<tr>
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<td>Hewlett-Packard</td>
<td>HPQ</td>
<td>28-Aug-06</td>
<td>20.3</td>
<td>0.60</td>
<td>35.37</td>
<td>50.18</td>
<td>41.87%</td>
<td>6%</td>
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<td></td>
<td>IBM</td>
<td>IBM</td>
<td>22-Jan-07</td>
<td>17.8</td>
<td>1.30</td>
<td>100.00</td>
<td>116.37</td>
<td>16.37%</td>
<td>7%</td>
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<tr>
<td>BONDS 5%</td>
<td>iShares Lehman 20+ Treas.</td>
<td>TLT</td>
<td>25-Jul-05</td>
<td>n/a</td>
<td>n/a</td>
<td>92.99</td>
<td>89.06</td>
<td>-4.23%</td>
<td>5%</td>
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<td></td>
<td>iShares Lehman 1-3 Treas.</td>
<td>SHY</td>
<td>30-Mar-07</td>
<td>n/a</td>
<td>n/a</td>
<td>80.53</td>
<td>81.02</td>
<td>0.61%</td>
<td>0%</td>
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<td>MONEY MKT.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>100%</td>
<td></td>
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</tbody>
</table>

### Notes:
1. **Date Purchased** is the date of The Peter Dag Portfolio when the stock was recommended.
2. **Price Paid** is the "Recent Price" as shown on the issue when recommended.
3. **Amount %** represents the amount of the portfolio allocated to each stock.
4. **Change %** does not include dividends.
5. **Asset allocation** is different from that of mutual fund portfolios (see page 4).

*Dag’s Exclusive Picks* provided a return to our subscribers of **7.4%** in 2002 (S&P 500: -23.4%), **30.4%** in 2003 (S&P 500: +26.4%), **16.9%** in 2004 (S&P 500: +9.0%), **4.1%** in 2005 (S&P 500: +3.0%), and **7.2%** in 2006 (S&P 500: +13.6%) (Source: *Hulbert*). **This portfolio appreciated 82.7%** since 2002 while the S&P 500 increased 23.5% (S&P 500 dividends excluded).

*To new subscribers: start your portfolio with the stocks with the highest allocation and then gradually increase your investments to match the model portfolio.*

*Your editor and staff could have positions in the above stocks.*
The objective of the following portfolios is long-term capital growth with low volatility of returns. They are “real money” portfolios.

ETF Model Portfolio

Recommendations: No changes are recommended at this time.

The portfolio is now invested in the following ETF funds (allocation is shown in %):

- Brazil/Russia/India/China – EEB (30%)
- Latin America – ILF (10%)
- Emerging Markets – EEM (10%)
- Energy – XLE (20%)
- Materials – XLB (10%)
- Water Resource Portfolio – PHO (5%)
- Defense & Aerospace – PPA (10%)
- Cash Reserves (5%)

Portfolio performance. This real-money portfolio was started on April 10, 2006. It increased 9.16% in September (S&P: +3.58%). $100,000 has grown to $119,016 as of 9/30/07.

Fidelity Mutual Fund Model Portfolio

Recommendations: No changes are recommended at this time.

The portfolio is now invested in the following mutual funds (allocation is shown in %):

- Southeast Asia Fund – FSEAX (30%)
- Wireless Portfolio – FWRLX (30%)
- Energy Services – FSESX (20%)
- Fidelity OTC – FOCPX (20%)
- Cash Reserves (0%)

Portfolio performance. This real-money portfolio was started in 1994. It increased 9.09% in September.

This real-money portfolio increased +14.3% in 2006 (S&P 500: +13.6%), +9.1% in 2005 (S&P 500: +3.0%), +11.2% in 2004 (S&P 500: +9.0%), +16.8% in 2003 (S&P 500: +26.4%), was down -1.7% (S&P 500: -23.4%) in 2002, up +3.4% in 2001 (S&P 500: -13.0%), and gained +0.9% (S&P 500: -10.1%) in 2000. $100,000 has grown to $322,745 as of 9/30/07.

This portfolio outperformed the Wilshire 5000 Total Return Index (risk adjusted) in the 1987-1994, 1987-1995 and 1987-1997 periods (Source: M. Hulbert). On a risk-adjusted basis, it was ranked No. 3 for total return for 10 years (Hulbert).

Vanguard Mutual Fund Model Portfolio

Recommendations: No changes are recommended at this time.

The portfolio is now invested in the following Vanguard mutual funds (allocation is shown in %):

- Windsor II - VWNFX (35%)
- Horizon Global Equity - VHGEX (20%)
- Mid-Cap Growth Index – VMGIX (30%)
- High-Yield Corporate Bond - VWEHX (5%)
- Prime Portfolio (10%)

Portfolio performance. This real-money portfolio was started in January 1979. The value of the portfolio increased 3.28% in September.

This real-money portfolio increased +14.3% in 2006 (S&P 500: +13.6%), +9.1% in 2005 (S&P 500: +3.0%), +11.2% in 2004 (S&P 500: +9.0%), +16.8% in 2003 (S&P 500: +26.4%), was down -1.7% (S&P 500: -23.4%) in 2002, up +3.4% in 2001 (S&P 500: -13.0%), and gained +0.9% (S&P 500: -10.1%) in 2000. $100,000 has grown to $322,745 as of 9/30/07.

This portfolio outperformed the Wilshire 5000 Total Return Index (risk adjusted) in the 1987-1994, 1987-1995 and 1987-1997 periods (Source: M. Hulbert). On a risk-adjusted basis, it was ranked No. 3 for total return for 10 years (Hulbert).

Past performance does not guarantee future results

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THE FRAMEWORK OF OUR INVESTMENT STRATEGY

History repeats itself. Why not take advantage of it!

The following information and charts closely reflect the approach to managing portfolios and portfolio risk as discussed in Dr. George Dagnino’s book Profiting in Bull or Bear Markets (McGraw-Hill), now available in Mandarin from McGraw-Hill Education.

BUSINESS AND FINANCIAL CYCLE CONFIGURATIONS

- STOCK MARKET
- MONEY SUPPLY
- YIELD CURVE
- DOLLAR

- ISM INDEXES
- INVENTORY CYCLE

- COMMODITIES
- INTEREST RATES
- INFLATION

Fig. 1. The positive action of the stock market, the steepening of the yield curve, and soaring money supply point to a stronger economy in 2008. I left the “You are here” arrows unchanged. See below for details and strategic implications.

Please note: The graph on Page 1 represents a hypothetical 12-month stock market cycle. The arrow on the graph is the result of combining the information of all our technical market indicators into a simple and easy to understand format to be used in the near term (about 6 months). This graph is not related to the cycles shown on this page, which represent the outcome of the analysis of economic and financial variables. The graphs in Fig. 1 on this page are used to guide our strategy and choice of asset classes. The closer the arrow is to a turning point, the higher the probability of that turning point taking place.
There is a lot of pessimism around. It is very depressing. This is the time to take a fresh look at the data and see if we are missing something. Or, to say it in a different way, could the concern of recent developments make us miss what is really going on?

Let’s look at the data and see what they are telling us.

1. The leading indicators are rising…strongly. The **stock market** is soaring (see next section). The **money supply** is growing at a very rapid pace (see Fig. 2). The **yield curve** is steepening and will continue to steepen in the near future (see Fig. 3). These reliable gauges suggest the odds favor **stronger economic growth in 2008**.

2. The leading indicators of the Conference Board, however, declined and the probability of a recession has increased to 39.6% according to the Bank of Tokyo-Mitsubishi. A recession is likely to occur when this probability rises to 95%. In other words, there is **no recession in sight**.

3. The data released by the ISM reflect a **manufacturing sector** expanding at an average pace. Short-term interest rates are more likely to decline than rise under these conditions (see Fig. 3).

4. Improving **orders** for durable goods and the torrid increase in **backlogs** (up 20.9% y/y) reflect a firm economy (see Fig. 4). Quite frankly it is difficult to predict dire business conditions with these trends in place.

5. Unemployment **claims** declined and remain in the 300,000-320,000 range, reflecting a firm labor market.

6. Personal **income** is rising at a nice clip, up 6.8% y/y. **Spending** jumped 0.6% last month. Consumers are doing well, jobs are plentiful, and people are ready to spend the money they make.

7. The **housing market** remains in shambles. The inventory of unsold homes keeps rising and is now at a 10 month supply. Keep in mind that the norm is close to a 3-4 month supply. The point is the housing debacle has a long way to go….years. **Sales prices** of new homes, not surprisingly, keep declining, down 14.4% since March.

8. Headline **inflation**, meanwhile, is declining in response to slower economic growth, up 2.0% y/y (see Fig. 5). In the past three months, however, medical care costs jumped 5.6% at annual rate, and food and beverages were up 4.6%.

9. Slowdowns in business activity have typically been associated with some type of **financial crisis**, lower **short-term interest rates**, and moderation in **inflation**. This business cycle is no exception (see Fig. 6).

10. **Commercial & industrial loans** have soared. It is hard to believe the economy is heading for a recession with business borrowing at the current strong pace, up 16.2% y/y (see Fig. 7).

11. **Short-term interest rates** are declining in the UK, US, and Canada. They are still rising in Japan and Europe (see Fig. 8).

12. **Global bond yields** have stabilized and seem to have reached a bottom (see Fig. 9).

13. **The dollar** keeps sinking. A worrisome trend (see Fig. 10).

14. The decline in the dollar is reflected by soaring **commodities** (see Fig. 11). And the decline in commodities reflects the loss of our purchasing power.
Fig. 2. The growth of the money supply is soaring and will continue to be strong. This type of growth usually anticipates robust business growth ahead.

Fig. 3. The indicators released by the ISM reflect a manufacturing sector expanding at an average pace. Our leading indicators, and the yield curve in particular, point to stronger growth ahead.
Fig. 4. Orders for durable goods are strong and backlogs are soaring. These trends reflect a sound manufacturing sector.

Fig. 5. Headline inflation is declining in response to slower growth in business activity.
Fig. 6. Inflation and short-term interest rates decline when the economy slows down typically accompanied by a financial crisis.

Fig. 7. Commercial and industrial loans are soaring. The economy cannot be as weak as reported when business borrows at the current strong pace.
Short-term interest rates are declining again in the US, UK, and Canada following the recent hiccup due to the subprime debacle. They are still rising in Japan and Europe.

Global bond yields keep trading in a broad range. They are unlikely to decline from current levels.
Fig. 10. The dollar continues sinking. Its collapse is bad news.

Fig. 11. The rise in commodity prices and gold is the mirror image of the decline in gold. It reflects our loss of purchasing power.
THE BOTTOM LINE

1. The **leading indicators** are rising.

2. **Orders and backlogs** are strong in spite of the weak housing sector.

3. **Consumers** are fine and are spending.

4. The **manufacturing sector** is in good shape.

5. The odds favor a **stronger economy** in 2008.

6. A weak dollar and a firm economy point to stronger **commodities**.

7. **Short-term interest rates** and **bond yields** cannot decline much in such an environment.
THE STOCK MARKET

Long-term fundamental trend

Declining short-term interest rates, stable bond yields, low PE relative to 10-year bond yields, and soaring money supply suggest monetary policy is conducive to rising stock prices.

The trend of bond yields remains bullish for stocks. The reason is the market peaks when yields rise for several weeks. This is not the case right now (see Fig. 12).

Fig. 12. Bond yields are stable. Yields will have to move substantially higher for the market to peak.

Technical perspective

Our technical indicators are off their extremely oversold levels, but they are still far from reaching the overbought levels that signaled a market consolidation.

The advance/decline ratio is rising again, but is still at oversold levels. The market peaks when this gauge reaches much higher levels (see Fig. 13).
Fig. 13. The advance/decline ratio is still at oversold levels and points to a stronger market in the coming months.

Fig. 14. The number of stocks above their 30-week moving average is still at levels associated with rising stock prices.

The number of stocks above their 30-week moving average remains at oversold levels (see Fig. 14). It will take several months for this gauge to reach bearish levels.

Meanwhile, the market is more likely to move higher. Any correction should be considered as a buy opportunity.

Investors’ optimism has improved in the past few weeks, but has not reached the extreme levels typically associated with market tops (see Fig. 15).
Fig. 15. Investors’ optimism is still at levels associated with a strong market.

Fig. 16. The trend is up.

I like to draw trendlines to get a feeling of the strength of the market (see Fig. 16). The market will be in trouble when the Dow breaks below the trendline in Fig. 16.

Our proprietary indicator, meanwhile, continues rising, pointing to higher stock prices. The time to worry is when this gauge stops rising and starts declining (see Fig. 17).

Fig. 17. The trend is up.
SECTOR & ETF RISK ANALYSIS

The purpose of this section is to recognize excesses and opportunities in sectors or leading stocks. We suggest you emphasize those sectors with a strong long-term and short-term momentum.

The strongest sectors in the past three months, in order of strength (1 strongest, 18 weakest), are:

1. Precious metals (GLD, GDX)
2. Energy (XLE, OIH)
3. Telecom (TTH, IXP, IYZ)
4. Technology (QQQQ, XLK, SMH)
5. Materials (XLB)
6. Currencies (FXE, DBV)
7. Industrials (XLI)
8. Water resources (PHO)
9. Consumer staples (XLP)
10. Utilities (XLU)
11. Consumer discretionary (XLY)
12. S&P 500 (SPY)
13. Healthcare (XLV)
14. Finance (XLF, IXG)
15. High-yield bonds (PHK, ALD, BNA, NCV)
16. Transportation (IYT)
17. Treasury bonds (long maturities) (TLT)
18. Homebuilders (XHB)

The strongest sectors are technology and commodity sensitive stocks. The message of the market suggests the economy is more likely to strengthen than weaken.
THE GLOBAL BUSINESS CYCLE

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Since 1977

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12-24-07
The latest composite leading indicators released by the OECD point to a moderate downturn in economic activity in the OECD area (see Fig. 1). The latest data suggest the major seven countries will slow down appreciably.

The Euro-area is likely to slow down more visibly than the US (see Fig. 2). Considerable weakness should be expected in France, Italy, and Japan.

The latest data for major OECD non-member economies point to continued strong expansion in China, India and Brazil but a weakening outlook for Russia.

**Fig. 1.** The economies of the industrialized world are going to slow down in a visible way. The Chinese economy, meanwhile, will continue to expand at a robust pace. The blue areas represent business cycle downswings.

**Fig. 2.** The US economy is going to slow down according to OECD data. The European economy is likely to sustain a sharp decline in growth. The blue areas represent business cycle downswings.
The international purchasing managers reported a slight improvement in the global manufacturing sector with the index finishing at 52.2. This level suggests the global manufacturing sector is growing close to 2%.

The global service sector continues to slow down, with the index closing at 54.2. Growth has slipped to a four and a half year low.

The global expansion (manufacturing and services) has eased to a 53 month low and the index is below its long-term average of 55.7. Overall global growth remains below 3%.

This is how the global markets are responding to recent business cycle developments.

1. **Short-term interest rates:** Short-term interest rates (libor rates) remain in a rising trend reflecting caution by the lenders (see Fig. 4).
2. Global **bond yields** have shown an up tick (Fig. 5).
3. The **yield curve** remains steep in Europe, a sign of monetary stimulus (Fig. 6).
4. The European **money supply** continues growing at a rapid pace (Fig. 7).
5. **The dollar** has rebounded, but the trend is down (see Fig. 8).
6. **The Baltic shipping index** has weakened, probably reflecting the global slowdown (Fig. 9).
7. **Major equity markets:** the strongest ones are EWZ, EEB, FXI, RSX, FNI, ILF, and EZA.
Fig. 4. Short-term interest rates rose again reflecting the cautiousness of the lenders in the midst of the current credit crunch.

Fig. 5. Bond yields jumped, but remain below the peak reached last summer.
**Fig. 6.** The European yield curve remains steep and reflects monetary stimulus.

**Fig. 7.** The European money supply M3 is growing at a strong pace as the ECB attempts to ease the worries of the credit crisis.
A WORRISOME TREND ASSOCIATED WITH STRONG COMMODITIES, AN INCREASINGLY VULNERABLE ECONOMY, AND LOSS OF PURCHASING POWER RELATIVE TO THE REST OF THE WORLD

Fig. 8. The dollar has strengthened but the odds favor more weakness ahead.

Fig. 9. The Baltic shipping index has been weakening in response to the gradual slowdown of the world economy.
THE US ECONOMY

Dr. George Dagnino, Editor

The Peter Dag Portfolio Strategy and Management

Since 1977

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INTERNATIONAL INFLUENCES

http://www.dallasfed.org
Real Value of the Dollar

March 1973 = 100

Source: Federal Reserve Board

http://www.dallasfed.org

* Euro Area, Canada, Japan, UK, Switzerland, Australia, and Sweden
U.S. Imports and Exports

Billions of Dollars

Source: Bureau of the Census
http://www.dallasfed.org
Industrial Production:
OECD Big 7 & OECD + 6

6-month % change, annualized

OECD Big 7: Canada, France, Germany, Italy, Japan, UK, U.S.
Major 6 Non-Members: Brazil, China, India, Indonesia, Russia, South Africa

Source: OECD
http://www.dallasfed.org
Industrial Production & Trend

OECD Big 7

Index 2000=100

OECD Big 7 (Dec 10 release, Oct=108.5)  Trend (Dec 10 release, Dec=105.4)

OECD Big 7: Canada, France, Germany, Italy, Japan, UK, U.S.

Source: OECD  http://www.dallasfed.org
Industrial Production & Trend
OECD + 6

Index 2000=100

OECD + Major 6 Non-Members (Dec 10 release, Sep=133.7)  Trend (Dec 10 release, Dec=131.3)

OECD Big 7: Canada, France, Germany, Italy, Japan, UK, U.S.
Major 6 Non-Members: Brazil, China, India, Indonesia, Russia, South Africa

Source: OECD  http://www.dallasfed.org
DOMESTIC ECONOMIC ACTIVITY

http://www.dallasfed.org
Home Sales

Thousands of New Homes

Thousands of Existing Homes


600 700 800 900 1,000 1,100 1,200 1,300 1,400

3,500 4,000 4,500 5,000 5,500 6,000 6,500 7,000

Existing Home Sales (Dec 31 release, Nov = 4400)

New Home Sales (Dec 28 release, Nov = 647)

Recession

Source: Bureau of the Census, National Association of Realtors  http://www.dallasfed.org
Consumer Confidence/Sentiment

Consumer Sentiment: Survey of Consumers, Survey Research Center, U. of Michigan
Consumer Confidence: The Conference Board

http://www.dallasfed.org
Housing Starts and Permits

Thousands


Source: Bureau of the Census

http://www.dallasfed.org
Initial Claims for Unemployment and Unemployment Rate

New Orders for Durable Goods

Billions of Dollars

Source: Bureau of the Census
http://www.dallasfed.org
Nominal Personal Consumption Expenditures

1-month % change

Dec 21 release, Nov = 1.12

3-year average

Source: Bureau of Economic Analysis

http://www.dallasfed.org
Note: December 2004 and January 2005 numbers exclude payment of special dividend by Microsoft Corp. Including special dividend payment Personal Income growth was 3.7% and -2.3% respectively.

Source: Bureau of Economic Analysis  http://www.dallasfed.org
Real Personal Consumption Expenditures

1-month % change

Source: Bureau of Economic Analysis

http://www.dallasfed.org
Index of Leading Economic Indicators

Source: The Conference Board
http://www.dallasfed.org
Real GDP

1-quarter % change, annualized

Dec 20 release, Q3 = 4.9
3-year average

Source: Bureau of Economic Analysis
http://www.dallasfed.org
Industrial Production

1-month % change

Source: Federal Reserve Board  http://www.dallasfed.org
Manufacturing Capacity Utilization Rate

- **Recession**
- **CU Rate (Dec 14 release, Nov = 79.9)**
- **Historic Average (1948-present)**

Source: Federal Reserve Board  
http://www.dallasfed.org
Retail Sales

1-month % change

Dec 13 release, Nov = 1.22
3-year average

Source: Bureau of the Census
http://www.dallasfed.org
Retail Sales, Excluding Autos

1-month % change

Dec 13 release, Nov = 1.81
3-year average

Source: Bureau of the Census
http://www.dallasfed.org
Change in Nonfarm Employment

Thousands of jobs

Source: Bureau of Labor Statistics
http://www.dallasfed.org
ISM Non-Manufacturing Activity Index

Dec 05 release, Nov = 54.1

Purchasing Managers’ Index

Dec 03 release, Nov = 50.8

Source: Institute for Supply Management™
http://www.dallasfed.org
Core PCE Price Index

1-month % change

Dec 21 release, Nov = 0.23

3-year average

Source: Bureau of Economic Analysis http://www.dallasfed.org
PCE Price Index

1-month % change

Dec 21 release, Nov = 0.57
3-year average

Source: Bureau of Economic Analysis
http://www.dallasfed.org
Consumer Price Index

1-month % change

Dec 14 release, Nov = 0.8
3-year average

Source: Bureau of Labor Statistics
http://www.dallasfed.org
Core Consumer Price Index

1-month % change

- Dec 14 release, Nov = 0.27
- 3-year average

Source: Bureau of Labor Statistics
http://www.dallasfed.org
Core Producer Price Index

1-month % change

Dec 13 release, Nov = 0.4
3-year average

Source: Bureau of Labor Statistics
http://www.dallasfed.org
Producer Price Index

Source: Bureau of Labor Statistics

http://www.dallasfed.org
Nonfarm Business Productivity

1-quarter % change, annualized

Dec 05 release, Q3 = 6.3
3-year average

Source: Bureau of Labor Statistics
http://www.dallasfed.org
Nonfarm Business Unit Labor Cost

1-quarter % change, annualized

Dec 05 release, Q3 = -2

3-year average

Source: Bureau of Labor Statistics

http://www.dallasfed.org
Commodity Prices

Source: Commodity Research Bureau  http://www.dallasfed.org
ISM Manufacturing Prices Index

Dec 03 release, Nov = 67.5

Source: Institute for Supply Management™
http://www.dallasfed.org
Employment Cost Index

1-quarter % change

- Oct 31 release, Q3 = 0.8
- 3-year average

FINANCIAL-SECTOR DEVELOPMENTS

http://www.dallasfed.org
Real Federal Funds Rate

Percent

2004 2005 2006 2007

End-of-Month Target Fed Funds Rate less SPF Expected Inflation

Target Fed Funds Rate (Dec 28) less SPF Expected Inflation (Nov 13)

End-of-Month Target Fed Funds Rate less U. of Michigan Expected Inflation

Target Fed Funds Rate (Dec 28) less U. of Michigan Expected Inflation (Dec 21)


http://www.dallasfed.org
Short-Term Interest Rates

Source: Federal Reserve Board

http://www.dallasfed.org
Long-Term Interest Rates

Source: Federal Reserve Board

http://www.dallasfed.org
Bond Spreads

Merrill Lynch’s Yield on Low-Grade Corporate Bonds, Moody’s AAA and BAA Corporate Percent

- Low-Grade Corporate less AAA Corporate (week of Dec 21 = 3.98)
- Daily (Dec 27 = 3.96)
- BAA Corporate less AAA Corporate (week of Dec 21 = 1.14)
- Daily (Dec 27 = 1.16)

Source: Moody’s Investors Service, Merrill Lynch  http://www.dallasfed.org
Yield Curve

Percent

3-Month T-Bill Rate (week of Dec 21)  10-year T-Bond Rate (week of Dec 21)
3-Month T-Bill Rate (Dec-27 = 3.17)  10-year T-Bond Rate (Dec-27 = 4.21)

Source: Federal Reserve Board
http://www.dallasfed.org
Money Supply: M1

1-month % change, annualized

Dec 27 release, Nov = -5.55
3-year average

Source: Federal Reserve Board
http://www.dallasfed.org
Money Supply: M2

1-month % change, annualized

Source: Federal Reserve Board

http://www.dallasfed.org