Building Your Wealth in Today's Bull Markets

2nd Quarter 2007 Update

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In March 2000, the S&P 500 Index hit the 1500-point level for the first time in history. Here we are, more than seven years later and the S&P is once again flirting with 1500. When the S&P first hit the 1500-point level, it was near the end of a long-term advance (secular bull trend) that began in 1982 and concluded in 2000. After 18 years of generally rising stock prices, the greatest equity bull market in U. S. gave way to a much different trend in 2000. From the beginning of this decade to date, stock prices (at least in the U.S. markets) are stagnant and cannot make any meaningful progress.

Secular bull trends go on to new highs, secular bear trends struggle to make meaningful progress for years. During the last secular bear trend, which occurred in the 1966 – 1982 period, the Dow struggled with the 1000 point barrier for 16 years.

Is it unusual to experience such extended periods of stagnant prices? No. In fact, a historical perspective of the stock market (or any asset class for that matter) shows us that following significant bull markets such as we experienced in the 1980's and 90's are extended periods of trendless, sideways moving stock prices. Near the end of secular bull trends, stocks trade at prices that are well above their fundamental value. This dynamic occurred in the late 1990's; stocks became overvalued. In effect, the stagnant periods that follow bull market trends serve the purpose of consolidating the previous long-term gains. Unfortunately, the consolidation phase can take a long time. Secular trends have an average length of 14 years. Eventually, fundamental value catches up and exceeds market price and another secular advance will begin. Most likely, it will take a number of years of stagnant prices, or a strong decline in prices, until fundamental values exceed today's stock market level.

While the S&P 500 and NASDAQ have languished, other asset classes are in a strong secular bull trend of their own. ***As you will read later in this report, we have identified two asset categories that are currently experiencing a powerful secular bull trend; emerging international equities and commodities/natural resource assets. Both of these asset classes can potentially provide the same wealth building opportunities this decade as the NASDAQ and technology stocks did during the 1990's.*** Investors focused in emerging international markets or natural resource assets are building their wealth at a rapid clip, while investors with a focus on the US stock market are merely getting back to the levels first reached seven years ago.

Have you adapted your investment strategies to be harmonious with the bull markets of this era? How will you grow your portfolio if the S&P 500 and NASDAQ continue to languish for several more years? **In this report, we explain growth strategies to help you make progress toward achieving security in retirement, even if the S&P continues to struggle for many more years.**

Build Your Wealth in the Lucrative Bull Trends Underway in Emerging International Stock Markets and Natural Resource Assets

The proper execution of this strategy can be the key to building your wealth over the next 5 to 10 years.

Every decade witnesses a massive price advance and speculative mania in at least one specific asset class. In recent decades, asset price appreciation builds up momentum and culminates in a price "bubble" near the end of each decade. Investors that are shrewd enough to recognize this trend can build meaningful wealth.

Courtesy of BCA Research, you can see how these manias unfolded in *figure 1* (page 5).

In the 1990s it was the U. S. equity market and in particular the NASDAQ that developed a bubble. **As technology, telecom and Internet stocks soared, the NASDAQ peaked in March 2000 at 5100.** *Investors in the NASDAQ built significant wealth in the 1990's.* Following the NASDAQ's bubble, it declined to a low of 1100, an 80% plunge.

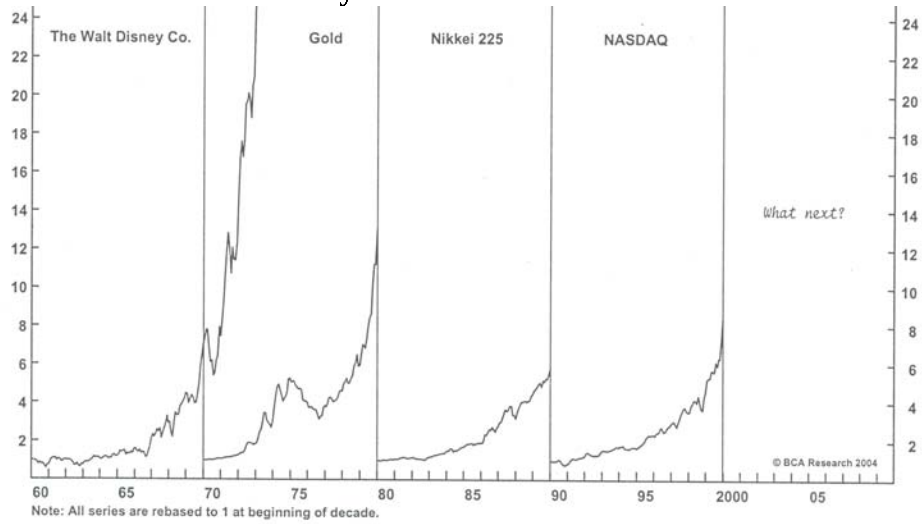
In the 1980s, Japan's equity market was the number one wealth-building asset class. **The Nikkei index peaked on December 31, 1989 near 40,000**. *Investors in the Nikkei in the 1980s built significant wealth.* Following the bubble in Japan's stock market, the Nikkei index declined all the way down to 7600 in 2003, down some 80%.

In the 1970s, the single best wealth-building asset class was in natural resources/commodities. **Gold in particular advanced throughout most of the decade with just a few abbreviated corrections. It peaked near $800 per oz. toward the end of the 1970s**. Following every secular advance is a secular decline. *Investors who owned gold in the 1970s built significant wealth.* Once the mania in gold ended, prices fell some 70% to a low of $259 per oz. in 1999.

Do you notice a pattern? In each of these examples, the mania built up momentum and culminated in a mania right at the end of each decade.

Which asset class will experience a massive price advance for the 2000s? We have identified two potential candidates that appear to have the same characteristics that gold, Japanese equities and the NASDAQ had mid way through their mania patterns. The first candidate is emerging international equities. This would include the stock markets in the emerging economies of the world; Asia ex-Japan, Latin America and Central & Eastern Europe. The second candidate is natural resources/commodities.

Every Decade Has a Bubble



BCA Research, copywrite 2004, www.bcaresearch.com *Figure 1*

The Next Mania: Emerging International Equity Markets

The industrialization of China and other rapidly emerging economies may prove to be the most important global economic development this decade. Conservative estimates suggest that China has nearly 160 million underemployed workers (i.e. citizens moving from rural areas into cities). It will take 10 – 20 more years to integrate these workers into the global economy.

While the economic development of China seems to grab most of the headlines, the opportunity extends into many other emerging countries too. Central and Eastern European economies are taking jobs away from the mature economies in Western Europe. There is an ample supply of cheap labor in the world. Economies with a high cost of labor, (developed countries) will continue to lose jobs to economies with cheap labor (emerging countries).

Capital, labor and investments flow without borders in today's global economy. Direct investment is flowing out of the U.S., Western Europe and Japan, and flowing into the emerging economies. China's industrialization kicked off this major macro-economic event, but the benefits are spreading throughout the emerging world. For example, the economies in Latin America have benefited substantially from robust Chinese demand for natural resources. Many Latin American stock markets are booming.

The economic backdrop in the emerging world is in better shape than ever before. Current account balances are rising, foreign debt has plunged, return on equity is up three-fold this decade, interest rates have declined from well above 20% in the early 1990s to about 4% today and consumer inflation has declined from double digits 10 years ago to 4% today. In summary, these are the soundest economies in the world.

Historically, emerging international markets experienced high levels of volatility and boom/bust cycles. The root cause of past instability was the combination of high interest rates and inflation. In the past, interest rates in emerging markets were higher than the return on equity, causing value destruction. In recent years, interest rates in emerging international countries fell below return on equity in these economies. This means companies can finally borrow money to fund capital projects that will return more than the borrowing costs. **This fundamental shift in emerging international countries has changed the economic environment from a stage of value destruction to value creation**. See *figure 2.*

Figure 2

Figure 3

Source: BCA Research, copywrite 2006, www.bcaresearch.com

How do we know a secular bull trend is underway for emerging international stock markets? The simple answer; this asset class continually establishes new all-time highs year after year since 2004. We enjoyed this same pattern in the US market in the 1980s and 1990s. You can see in *figure 3* that the emerging international asset class was stuck in its a trading range for ten years from 1994 to 2004. **The emerging international asset class broke out of a secular bear trend in recent years and is now clearly in the early stages of a new secular bull trend**.

Following the global recession and bear market in the 2000 – 2002 period, emerging country markets were the first broad stock market category to be able to push ahead to a new all-time high in 2004. This pattern signals that emerging country markets are the new global leaders. The strength in emerging markets continues today. The chart in *figure 4* shows you that in the three years since the 2004 breakout, emerging stock markets have doubled in value.

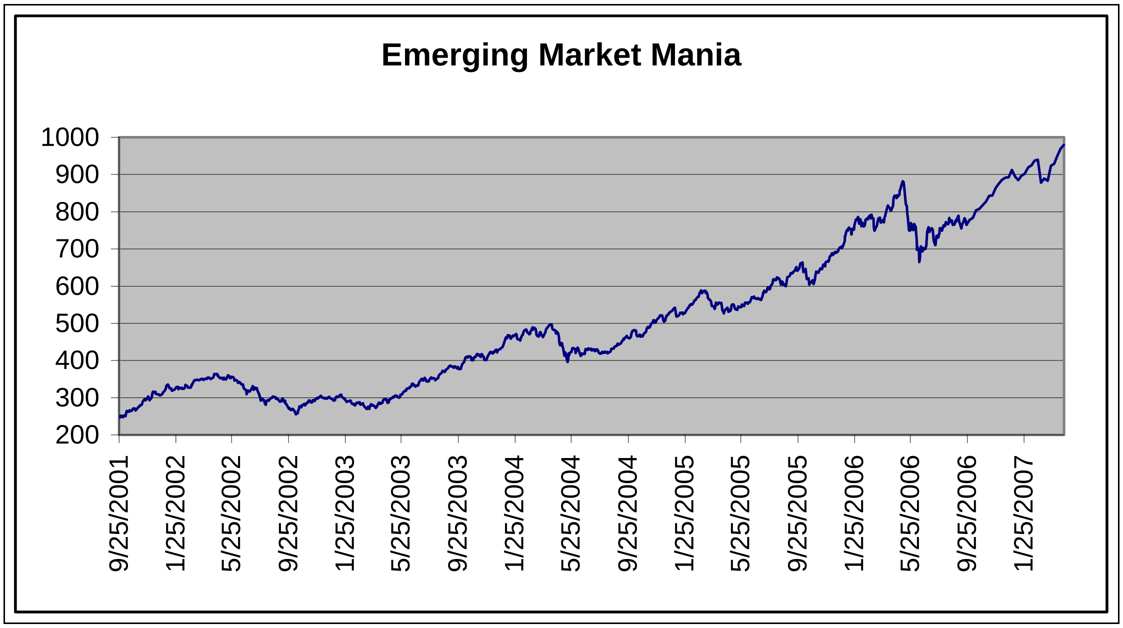


Figure 4

You might expect, given the attractive economic trends coupled with new all-time highs recently attained, that valuations in emerging stock markets would be sky high. Surprisingly, these markets are trading at reasonable valuations. In many cases, you could buy stocks in emerging countries for better prices than in developed country markets. For example, while P/E ratios in the S&P 500 index are approximately 18, the P/E ratio in Brazil is 9. This combination, strong fundamentals and good valuations, is creating an investment opportunity for you for the next several years.

The solid fundamental backdrop, attractive valuations and a breakout in the secular trend is a magnet for capital around the globe. The global appetite for emerging market equities exploded in recent years. Foreign purchases in emerging market equities are surging, rising nearly seven-fold in the last six years! Further, the available supply of emerging market equities as an entire asset class is extremely low. The combined market capitalization of emerging Asia, Latin America and emerging Europe totals approximately 18% of the world's stock market capitalization. A massive price advance and potential mania can build in emerging market equities, as investors from all corners of the world are attracted to the sound fundamentals, low valuations and a breakout in the secular trend, creating substantial demand for emerging international equities. Similar to previous secular bull trends, such as the NASDAQ bull market in the 1990s, rapid wealth creation can result. The supply of emerging market equities will be unable to satisfy the demand, causing valuation ratios to shift to a premium.

Emerging market equities have surged nearly 300% in the last 5 ½ years and, as a result, are now extended on a short-term basis. Asset classes that are entrenched in a secular bull trend will experience abbreviated price corrections. Remembering the 1982 – 2000 secular bull trend in the U. S. stock market, several strong price corrections occurred, creating an ideal time to buy. Inevitably, similar corrections will occur in emerging markets providing you a lower risk entry point.

Natural Resources: On Track for a Mania

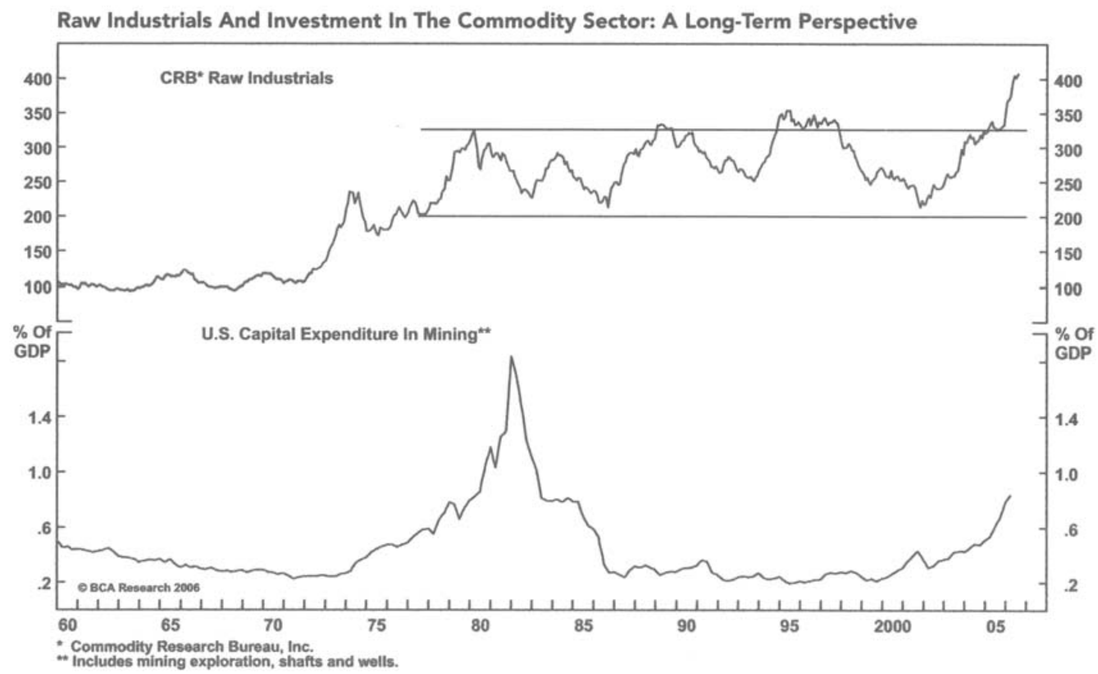
Our second candidate for superior long-term returns lies in the natural resource asset category. As mentioned previously, these assets experienced a secular advance in the 1970s that ended with a rapid escalation of commodity prices. Every bubble is destined to burst and a secular decline follows. During the 1980s and 1990s, commodities experienced a secular decline.

Natural resource prices were stagnant for more than 20 years (secular bear trend) following a major price advance in previous years (secular bull trend). **Even after a strong recovery in commodity prices over the last six years, when adjusted for inflation, many commodities are still significantly below previous peaks.** In many cases, natural resource prices can double before getting back to their previous inflation adjusted high. Furthermore, once price momentum builds in commodities or any asset class; prices tend to overshoot, rising well above levels you would expect.

Natural resources are now in a new secular bull trend after breaking out of a 20-year secular bear trend (see *figure 5*, upper panel). Over the last six years, commodity prices advanced rapidly, finally making a new all-time high in recent years. Supply and demand relationships play the key role in every market trend. When commodity prices plunged for approximately 20 years, from 1980 thru 2000, capital investments to produce more commodities plunged too. Capital expenditures to produce new sources of commodities declined during the secular bear trend while prices were stagnant (see *figure 5*, lower panel). Now that demand for natural resources is back on the rise, the infrastructure needed to produce increased supply is lacking. This dynamic has created a classic supply-demand imbalance.

Increased natural resource demand is coming from China and other emerging economies in the world. The rapid industrialization of third world countries has absorbed the global supply of natural resources. The emerging international investment theme discussed in the previous section of this report is feeding the natural resource investment theme. The two opportunities are feeding off of each other.

As commodity prices rise, capital expenditures on mining are on the rise too. However, new projects cannot be completed overnight. It will take years to make it through regulatory red tape, construction, etc. Eventually, enough new capacity will be able to meet the demand coming from the emerging world and the cycle will turn negative again, but that not happen in the immediate near future. **The lag in supply creates a window of opportunity for proactive investors to allocate a portion of their portfolio into natural resource assets.** Commodity prices have been on the rise since 2000 and the secular bull trend is approximately 50% completed. The best years are still ahead for investors in natural resources, as the secular advance will continue at least through the end of this decade.



Source: BCA Research, copywrite 2006, www.bcaresearch.com *Figure 5*

Energy prices are up sharply in the last few years. Energy related commodities are enjoying a major advance. For 30 years, a barrel of oil traded in a range from around $10 on the low end to a high of $40. The average price was $25. The world has a huge supply of oil that carries a high production cost. In fact, much of this supply is right here in North America. Canada is loaded with high cost oil. Oil prices broke the old 30-year range in 2004 and began a major advance. The new price range for oil is likely to be $40 - $80. At an average price of $65, oil companies are extremely profitable.

Higher oil prices are creating new energy related investment opportunities. One attractive sub-sector of the energy industry is the Oil Service sector. Energy production and exploration companies are operating at full capacity, keeping the service companies humming. The industry has a record backlog with no end in sight over the immediate future. This creates a profit windfall for oil service companies and a lucrative investment opportunity for us.

Using one oil service stock as an example, Cameron International (CAM) provides flow products and services to the oil & gas industry worldwide. Fundamentally, Cameron's business is sound. Technically, Cameron's shares recently made an all-time high and it remains poised to move higher in the months ahead.

The trading pattern of many oil service companies is similar to Cameron's pattern. F*igure 6* is a point & figure chart for Cameron Intl. If you are not familiar with point & figure charts, it measure's a stock's supply and demand relationship. We use point & figure charts to help us isolate stocks that are beginning new trends. We want to participate relatively early in the trend and stay with a position as long as the trend remains positive. Looking at the chart, you will see a sizable price advance from the low in 2003 at $21 to an interim peak in 2006 at $66.

Cameron Intl. (CAM)

Point & Figure chart

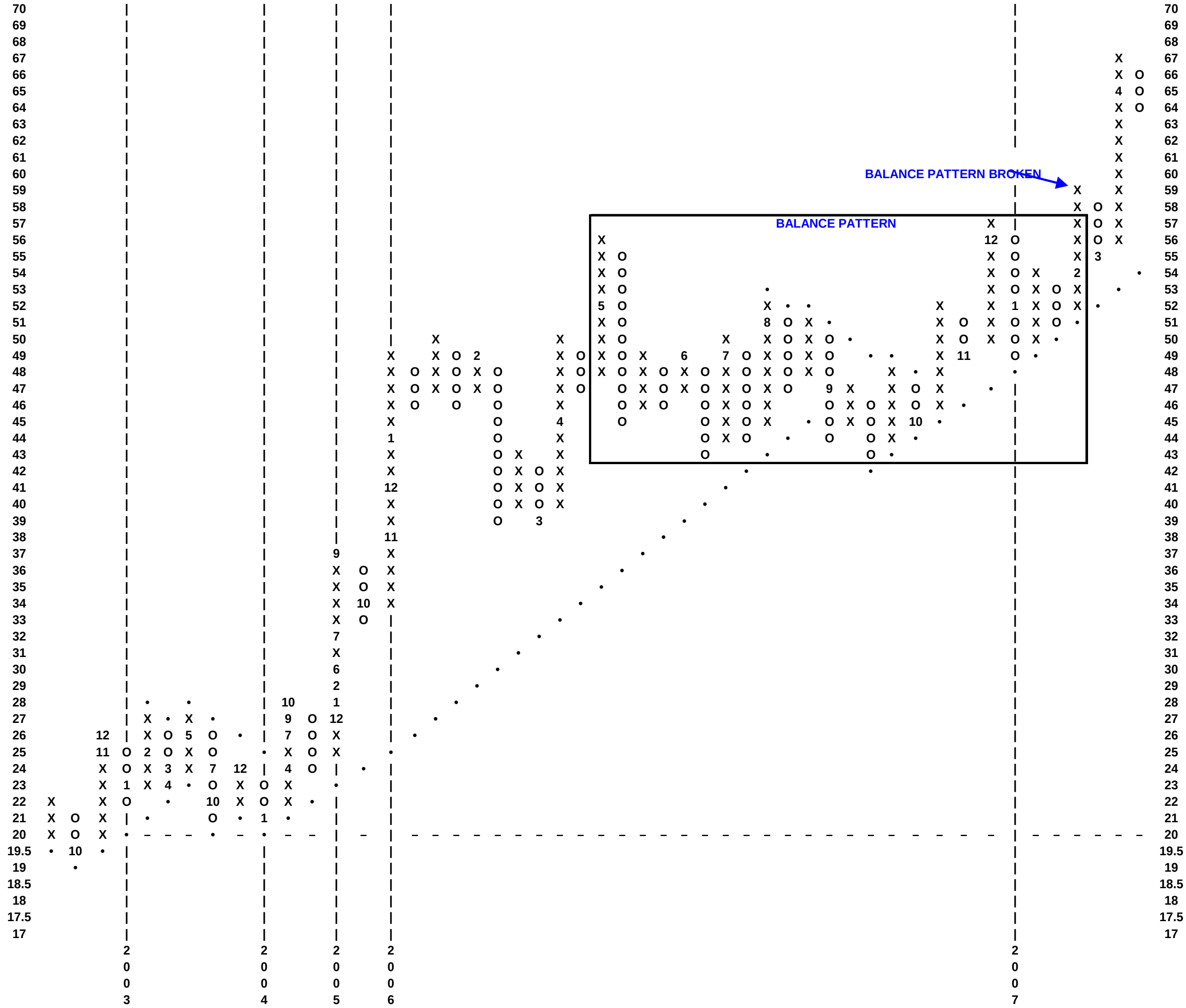


Figure 6

The move from $21 to $56 indicates a huge amount of demand relative to supply available. After reaching $56 in May 2006, the price became over extended and supply caught up with demand. A multi-month consolidation followed, when the shares traded in a sideways pattern (I call this a balance pattern; balance in the supply-demand relationship) into the early months of 2007. This pattern serves the purpose of digesting the previous gains. Following the consolidation, Cameron's shares are breaking out into new territory. This technical action indicates that demand is taking control of Cameron once again and a new up-leg of its long-term advance is underway.

The pattern in Cameron is indicative of the pattern occurring in many other oil service companies, suggesting Cameron is not the lone ranger experiencing this dynamic. Instead, this appears to be an industry phenomena. In fact, this pattern is not restricted to the oil service sector, but extends into many other sub-sectors in the energy and natural resource industries.

Consider, for one more example, Cameco Corp. (CCJ). Cameco produces uranium for use in nuclear power generation. Uranium prices tanked during the 1980s and 1990s. Many companies in the uranium exploration and production industry left the business, leaving only a few publicly traded companies. Now that uranium prices are exploding, Cameco is enjoying a profitable ride. Its shares exploded too, rising from $2 to $45 in three years. Cameco's point & figure chart (see *figure 7*), shows the strong advance from 2003 up to an interim peak in May 2006.

Cameco (CCJ)

Point & Figure chart

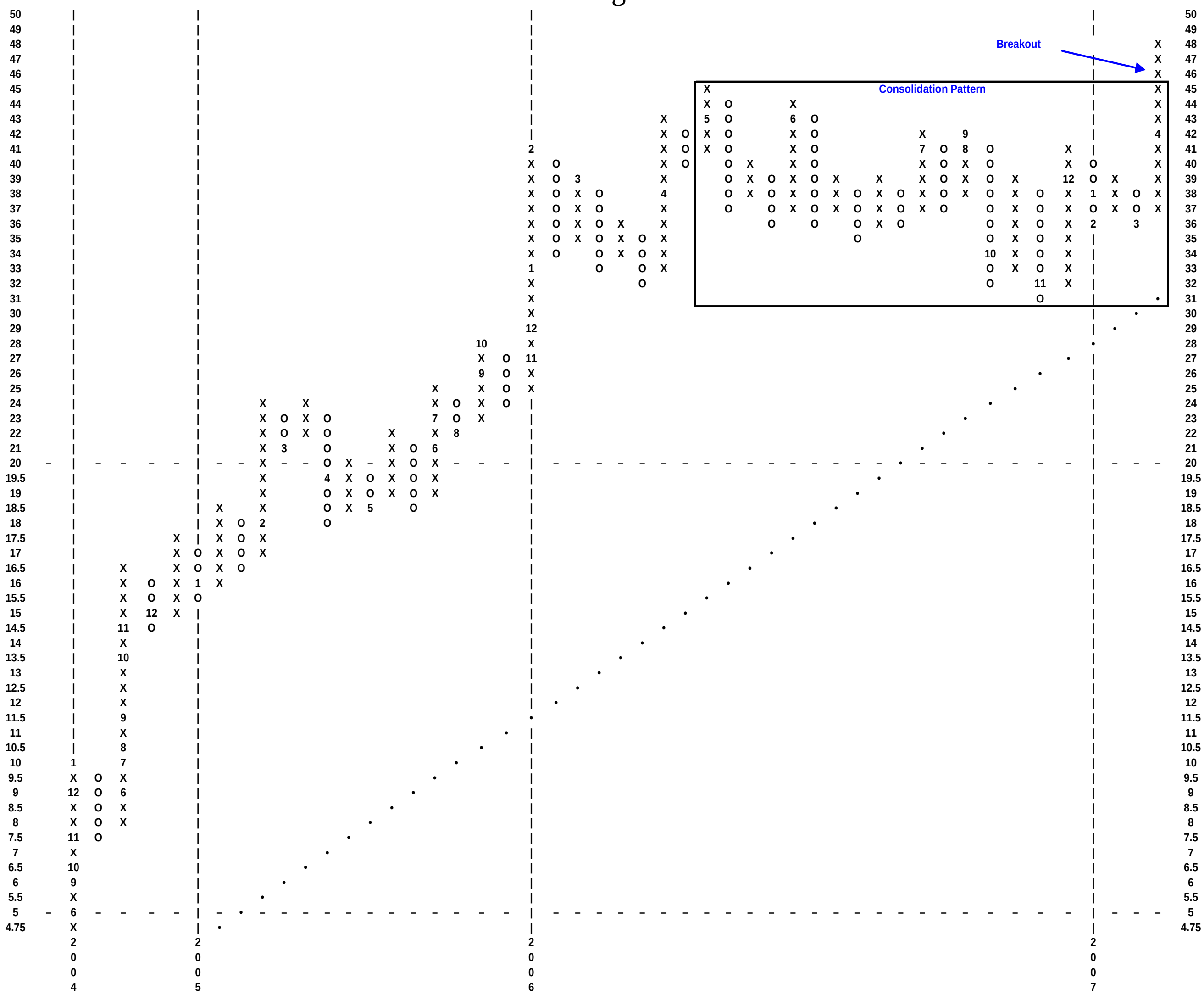


Figure 7

Do you see any resemblance on this chart comparing it to the Cameron Intl. chart shown in *figure 6*? Following a large-scale increase, both charts reached an interim peak in May 2006 before beginning a multi-month consolidation phase. Similar to Cameron Intl., Cameco's chart recently broke through the previous resistance level and pushed into new territory. Once again, this pattern indicates that demand is taking control and the next up-leg in the long-term trend is emerging.

Assets in the energy and power production industry are in a secular advance. With oil positioned above $60 per barrel, sources of oil that previously were too expensive to produce, such as the Canadian Oil Sands, are now profitable. There are several lucrative opportunities available in the Canadian energy industry. Additional opportunities are available in alternative energy sources. One prime candidate is "clean power" such as solar energy. We own several solar power companies in our managed portfolios. In fact, Cameco is also considered a "clean power" company because uranium is used to produce nuclear power, a form of "clean power".

Energy related commodities are not alone in a secular bull trend. Many other natural resources are also attractive. Metal prices, both precious and industrial metals, are entrenched in a secular advance of their own. Our natural resource strategy includes exposure to gold, silver and other metals, along with the lucrative opportunities available in energy.

Conclusion

An understanding of the powerful secular (long-term) trends that are in place this decade is necessary for you to adapt to new market dynamics. Repositioning your portfolio in an allocation that is harmonious with today's bull markets will enable you to participate in rapidly rising asset prices while avoiding undue exposure to assets that will remain stagnant for an extended period. Proactive investors will adapt their investment strategies in accordance with the prevailing secular trends.

Market dynamics are different today, than they were in the 1980's and 1990s. Yesterday's strategies will only produce disappointing results this decade. Getting desirable results from your investments in the 2000s requires new strategies. In this report, we have outlined dynamic growth strategies to build your wealth. Begin to put these strategies to work for your personal benefit and they will instantly help you become more in tune with current market conditions. They will help you achieve security in retirement and enjoy life.

Our investment management team is actively executing proactive strategies for our Private Client Group. Perhaps this is an appropriate time for you to evaluate your current investment strategies or professional relationships. Afterwards, if you find that your portfolio is not positioned to be harmonious with the prevailing secular trends, we invite you to a personal consultation with one of our advisors. During the consultation, you can have your current investment program analyzed and gain valuable insight to the benefits our clients receive.[i]

Information regarding wealth management services is available at www.arlington-capital.com. To request your consultation:

1. Call our offices at 847-670-4030.
2. Send an email to inquiries@arlington-capital.com.
3. Request at www.arlington-capital.com/ConsultationRequest.

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[i] ACM Private Client Group members have a minimum of $250,000 under the investment management of Arlington Capital Management. Consultation available for qualified investors only.