MARTIN WEISS' Safe Money REPORT

January 2003 Issue #345

Weiss Early Warning Index:
S&P 500 — 39% Overvalued

S&P: Bearish
Nasdaq: Bearish
Bonds: Bearish

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My Forecasts For 2003

One year ago, I warned you that unemployment would rise, and it did. I told you that corporate earnings would continue to plummet, and they did. I told you America's real budget deficit would surge to $600 billion or more — it has surged to $800 billion. I told you the stock market would plunge for a third year — the S&P fell *another* 23.4%.

Now, I have eight more forecasts for 2003 ...

Forecast #1
The economic "recovery" will fizzle.

We have just seen the worst December decline in the Dow since 1931 ... the longest bear market since the 1940s ... and the worst holiday sales since 1972.

We have the worst mortgage default rates in history ... the most personal bankruptcies ... the worst accounting scandals ever ... and the largest corporate failures of all time.

And they're still trying to reassure you that this is the "real recovery"!?

It's a joke, but no one is laughing. Too many investors have taken too many beatings based on similar reassurances in recent years. Too many others still take these promises too seriously, jumping back into the market even as the economy sags.

To see what I mean, just step back from the trees for a moment and take a look at what's been happening:

First, the consumer, the last great hope for the economy, is conking out. In November, we began to see concrete signs of a decline in home prices. In December, consumer confidence plunged unexpectedly. Also in December, consumers snubbed virtually any product that was not on sale.

Second, unemployment is up dramatically. In the past two years, more than two million US residents have lost their jobs. But even these numbers understate the severity of the job crisis in America.

The chronically unemployed — those who have been out of work for more than 27 weeks — has jumped 162%, from 648,000 in January 2001 to 1.7 million in November 2002, with still *more* discouraged workers that don't show up in any government statistics.

Third, corporate debt, already a noose around the necks of American business, has gotten worse.

At the end of September 2002, corporate debt as a share of net worth stood at over 57% — a new record. Despite 12 months of so-called economic recovery, corporate debt — now at $4.9 trillion — is, by far, the largest ever. Result: More companies on the brink of bankruptcy.

Moody's agrees. In 2002, *the rating agency downgraded a record 647 corporate bonds, while upgrading only 129 — the fewest since 1991.*

My forecast: The incipient decline you saw in 2001 was merely the opening scene in a long, multi-year recession. The decline will resume in 2003, driving corporate earnings into the gutter and stock prices into one of the sharpest tail-spins of the entire bear market.

The Dow will head toward my long-term target of 5000 or lower. The Nasdaq will plunge toward 800 and below.

My advice: Take advantage of any temporary improvements in the market to ***SELL!*** Sell your stocks. Sell your stock market mutual funds. Sell your real estate, collectibles, business, and any assets vulnerable to the economic decline.

Save as much money as you can and build up as much cash assets as possible. Later, once the crisis ends, you will be able to use the cash to pick up incredible bargains. You will buy stocks in America's best companies for pennies on the dollar ... once high-rated corporate bonds for a fraction of their par value ... and valuable real estate properties for discounts of 50%, 60%, 70%, or more.

But now it's still far too soon to buy.

Forecast #2
US will go to war against Iraq. Oil prices will surge. Gold will soar.

The chances of avoiding a second Gulf war are diminishing by the day.

That's too bad. Whether you're for or against it, the fact remains that, economically speaking, the US has virtually nothing to gain from the war ... but much to lose.

Contrary to popular belief abroad, the United States is not aiming to make a grab for Iraq's oil reserves. Nor is the US economy going to get much of a boost from increased defense spending. At best, it provides a one-shot stimulus.

Now consider the potential downside: Another reason for American consumers to cut spending ... another $100 billion added on to the ballooning federal budget deficit ... another trigger for foreign investors to dump more of their dollar investments ... another pitch Mideast extremist groups will be using to recruit more followers ... and another threat to the flow of oil supplies, exacting, in effect, a huge tax on nearly all corporations and consumers worldwide.

My forecast: Expect crude oil prices to surge to $50 and gold to surpass $400. However, there will be a big difference between the two: While the oil price rise is likely to be temporary, the gold price rise should continue.

My advice: With the exception of Enerplus, which is not impacted by oil price gyrations, stay away from energy stocks right now. However, hold all your gold investments. They will be driven higher by fundamentals that have nothing to do with the war.

Warning: When the war begins, it could be too late to start buying gold for this move. So if you're not yet on board, buy now. (See page 9 for details.)

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Forecast #3
The US dollar will plunge!

The dollar is another bubble. From its mid-1990s low to its peak, it surged 64% against the Swiss franc and 69% against the Japanese yen. It gained dramatically against the British pound, the euro, and virtually every major — and minor — currency in the world.

Now, however, the dollar surge has ended, and I see a still deeper decline in the cards. My reasons:

First — the decline in the US economy. Until this year, the second and third largest economies in the world — Japan and Germany — have been leading the global economy downward. In 2003, however, I see the opposite happening: Although Germany and Japan will continue to slide, the US economy is likely to slide even more swiftly. Result: A further fall in the dollar.

Second, the falling dollar could set off an avalanche of foreign selling in the US market, driving the dollar down still further.

Remember: Japanese and German investors have taken a tremendous beating in their own stock markets: Japan's blue chip index — the Nikkei — is off 19% in 2002, with a 12-year overall decline of 78%. Germany's blue chip index — the DAX — was down 44% in 2002 alone, for a total three-year decline of 64%.

In contrast, US blue chips are in relatively better shape — with many near break-even or even in the black.

Consequence: Foreign investors will now have *three* powerful reasons to dump their US holdings — the sinking US economy ... fear of a falling dollar ... and a pressing need to offset fatal losses in their domestic stock portfolios.

This is a potentially huge factor in our markets, and yet it is being largely ignored by Wall Street gurus. Don't they see that foreign investors have $1.5 trillion in US equities and another $1.4 trillion in bonds? Don't they know what can happen when those investors start selling? It helps drive down our three most critical markets, all at the same time: *Stocks ... bonds ...* and *the US dollar.*

My forecast: In 2003, the dollar will fall by an average of *at least* 20% against all major currencies.

My advice: Allocate 10% of your conservative portfolio to mutual funds that are poised to go up when the dollar goes down. (See page 6 for details.)

Forecast #4
Despite a dollar decline and a spike in oil prices, deflation will spread abroad and in the US.

Energy prices are rising. So are some basic commodity prices. As the dollar declines further, imports become more expensive as well.

Possible outcome: A revival in inflation fears and perhaps a temporary blip in various price indexes in

Our New Year's Resolutions

The year 2003 will go down in history as one of the worst years in the great bear market.

So if you are not already fully prepared for what's ahead, it's not too late to take action.

To help you achieve your goals, Larry and I — plus our entire staff — have made several New Year's resolutions:

First, we have resolved to make our investment recommendations easier for you to implement: We will provide even more specific instructions on how, when, and where to buy or sell the investments.

Second, we are simplifying the number of portfolios from three to two — Mr. Conservative and Mr. Speculator.

Rest assured, we will continue to cover all of the same investment recommendations. The only difference: You will find our LEAPS advice under Mr. Speculator and any new Crash Protection instructions in a special box. (No change to Larry's Gold column.)

Third, we have resolved to stay in touch with you more frequently. Events that used to take months to develop are now hitting in weeks or even days. There are more shocking revelations, more failures, and more dramatic changes. So, we will be sending you special in-depth issues and news alerts more often by mail — all as part of your regular *Safe Money* subscription.

Fourth, get ready for one heck of a great surprise coming in 2003 — our new *Safe Money* website. More details to come.

Overall, I'm convinced we're headed for even more challenging times. So I'm determined to do everything humanly possible to help you through them.

2003 — commodity prices, producer prices, even consumer prices.

But don't let it fool you. Even if there is a temporary return of inflation, it will be short and deceptive. The deflationary forces are far more powerful:

* The decline in the US economy will drive most prices lower.

* Impending debt defaults and bankruptcies will force hundreds of companies and tens to thousands of households to dump their assets in fire sales; and nothing can drive prices down into the gutter more quickly than bankruptcy.

* Even surging oil prices can drive the prices on non-energy goods *downward*. Why? Because the higher energy costs make it harder for companies and individuals to spend their money on other goods and services. And depressed demand = depressed prices.

My forecast: Virtually every asset imaginable will ultimately be impacted by deflation.

Forecast #5
Mr. Bush and Mr. Greenspan will try to pump up the economy and the stock market, stimulating false rallies. But they will fail.

First, the President will try more tax cuts. Mr. Bush wants to accelerate plans to shave the top tax rate from 38.6% in 2002 to 37.6% or perhaps 35% for 2003. He wants to repeal the estate tax permanently, extend tax credits for research and development, and raise limits for tax-exempt contributions to 401(k) and individual retirement accounts. He's also talking about cutting the tax on stock dividends for public companies.

Here's why I believe the effort will fail:

■ Mr. Bush has already cut taxes. It didn't work for 2002. Why should it work in 2003?

■ No matter how large, the tax cuts would be too little too late for the US economy. The December decline in stocks alone wiped out $854 billion in shareholder wealth.

■ The tax cuts are *too much, too soon* for the Federal deficit. Indeed, the US Treasury's final summary of the Federal budget for 2002 shows a $159 billion deficit.

That's bad enough. What's worse is that the *real* deficit, as indicated by the Federal Reserve in its *Flow of Funds*, ran at the annual rate of $1,014 billion in the second quarter of 2002. And for the first three quarters of 2002, it ran at an average annual rate of $812 billion!

■ State and local governments are in serious fiscal trouble. But by law, most states don't have the luxury of running a deficit — they are forced to jack up taxes or cut expenditures to get their budgets back into balance. Result: Their actions can easily wipe out any stimulative impact that Mr. Bush can achieve with his tax cuts.

Second, Mr. Bush is bound to propose a variety of gimmicks to reduce unemployment. He will probably do away with some regulations that supposedly hinder hiring. He may institute a new energy policy that is supposed to create new jobs. And I figure he'll allow businesses to write off more of their capital expenditures.

Problem: Most companies aren't hiring. Period. Regardless of what Mr. Bush says, their economic projections are turning sour. They see declining sales, rising costs, and falling earnings. So, despite all the cajoling and incentives, American businesses will do what they want to do anyhow — continue to cut jobs.

Third, the Fed will try to ease money. Problems:

1. They've done that already, and it didn't work.

2. Short-term interest rates are already so low, there's hardly any room left to cut.

3. Due to the low rates, bankers are reluctant to lend money. So, paradoxically, rate cuts can result in less credit, not more.

My forecast: Neither Mr. Bush nor Mr. Greenspan will stop asset prices from falling. Nor will they prevent a deepening recession. At best, they will stimulate more temporary market rallies and raise more false hopes.

My advice: Use any such rallies as selling opportunities — not just for your investment portfolio but for any and all assets that might decline as the economy sinks. Also use the rallies as your opportunity to buy bear-market investments for protection and for pure profit. (See page 7 for details.)

Forecast #6
Many MORE US companies will go bankrupt!

In 2002, 186 publicly traded companies filed for Chapter 11. Just with those companies alone, a record $368 billion in debt wound up in bankruptcy court. And all this despite

a so-called "recovery" in the economy!

As you know, our specialty is analyzing the financial soundness of nearly every listed company and every financial institution in America. So we were the first — and often the only ones — to warn of these failures.

Among the 186 companies that failed, we rated 120. And 98% of these were on our endangered list at least three months prior — with an overall Weiss Rating of weak or very weak.

With so many companies already bankrupt, you'd think that our list of endangered companies would have shrunk. Not so! As we open 2003, the list of companies with a Weiss Rating of E+ or lower has grown from 798 in January 2002 to 1,141 in January 2003.

What are their names? I will send you the list of the largest endangered companies in a special mid-month issue of *Safe Money* within a couple of weeks.

My forecast: No one can say for sure which companies will go under or when. But expect anywhere from 200 to 400 failures by publicly traded companies in 2003.

Accounting Troubles A Major Cause of Failure

We were also among the first to warn you that companies routinely hide losses, overstate earnings, disguise bad debts, exaggerate their capital, and use a plethora of creative accounting practices that would make a bookie blush.

That's why way back in September 1999, the main headline of *Safe Money* was: "28% of US Companies Are Telling Half Truths or Outright Lies About Their Earnings."

That's also why I nailed Enron six months before it failed and why I told you in early 2002 that Enron was just the first of many — that hundreds more would be caught cooking their books.

Now, I warn you flatly: *Nothing has changed. The worst is yet to come.* Consider these facts:

Fact #1. The pace of new and shocking accounting revelations has shown no sign of slowing. Just in the past few months, hundreds more have admitted errors, with many implicated in accounting malfeasance and even fraud:

Take Tyco, for example. For months, it swore up and down that its only crime was the theft by its former CEO. Now, it has just announced that it had overstated earnings for five years. Worse, the company's higher-ups literally ordered accounting gimmicks in various divisions.

Or look at Kmart, which has admitted it would restate its financial results from 1999 to 2002, due to "errors" in how it recorded leases and payments to vendors. Lee Enterprises, Neoforma, and dozens of others have admitted to equally serious errors in their earnings.

My forecast: Many more shocking revelations are yet to come. Reason: Half truths, lies, and outright fraud continue to be a routine business practice in thousands of American companies.

Fact #2. The so-called accounting reforms passed by Congress last year are going nowhere.

The Sarbanes-Oxley Act was a step in the right direction. But it also harbors several critical weaknesses: It did not require accounting firms to make a clean separation between consulting and auditing, the primary source of the conflicts of interest. It did not prevent companies from picking and choosing the firms they want to be audited by. It didn't even prevent companies from firing auditors that they feel are "too tough."

And now, even the Sarbanes-Oxley Act is stuck in limbo. According to Joel Seligman, dean of the Washington University School of Law, never before has a securities law had "a slower or more inept [beginning]. They don't have a full board, don't have a budget, don't have a staff, don't have an office, don't have a plan."

As a result, *most of the Big Four auditing firms — the same ones that presided over the biggest corporate accounting scandals in history — are generally proceeding with business as usual.*

Fact #3. Wall Street and Washington have barely begun to grapple with accounting gimmicks that are still defined as "perfectly legal" under current GAAP rules.

Despite all the public criticism, hundreds of major companies continue to grant options to executives without charging them as an expense — an unabashed deception that continues to erode and corrode the wealth of shareholders.

Hundreds more are overestimating how much they're going to collect from their customers who are in arrears.

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Mr. CONSERVATIVE
A Portfolio For The More Conservative Investor

How To Protect Yourself Against A Potentially Sharp Dollar Decline

In recent years, I have almost never recommended foreign currency investments, for two very simple reasons:

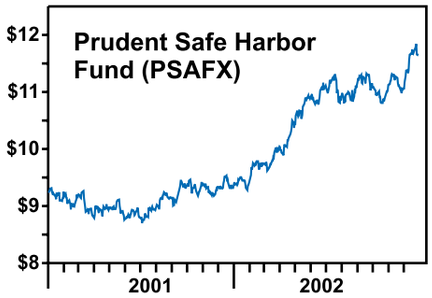
Reason #1. ***They were going down!*** The British pound plunged from a peak of $2.02 to a low of $1.3682; the Swiss franc fell from 90 cents to 54 cents; and the value of 100 Japanese yen crashed from $1.25 to 74 cents.

Reason #2. Gold served as a far better hedge against a major dollar crisis, rising handsomely even as foreign currencies fell. On average, our gold portfolio is up just about 300%, compared to a 37% rise in the XAU gold index and a 35% decline in the S&P 500.

Now, however, with confirmation that the dollar decline will deepen, it's time to take additional protective action. I recommend you follow these steps:

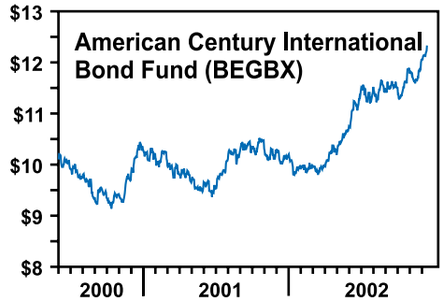
Step 1. Allocate 5% of your total conservative portfolio to the Prudent Safe Harbor Fund (PSAFX, $2,000 minimum.) This is a no-load mutual fund with essentially the same goals as the *Safe Money* conservative portfolio — yield and protection in a volatile economic environment.

The big difference: While *Safe Money's* cash equivalents and government securities are exclusively in US dollars, the fund's are mostly in foreign currencies. Currently, 25% of the total portfolio is allocated to cash equivalents and government securities denominated in Swiss francs, 18% to those denominated in euros, 5% to Swedish kronas, 5% to Norwegian kroners, 4% to Canadian dollars, 3% to Danish krones, and 24% to US dollars. That adds up to 84% in cash and governments. The balance (16%) is in gold and gold shares.



Any dollar decline is bound to drive this fund's value higher, and indeed, that's what's been happening in recent months: The fund has risen steadily from a low of $8.70 in the first week of July 2001 to its latest high of $11.84 on the day after Christmas. But I think this is just the beginning of a steeper appreciation. For more information, call 1-800-711-1848 or visit www.prudentbear.com/funds_pshfund.html.

Step 2. Allocate another 5% of your total portfolio to the American Century International Bond Fund (BEGBX, $2,500 minimum). This is also a no-load mutual fund concentrated in foreign government securities, but with a different mix — 65% to Eurozone nations, 14% to Japan, 8% to the UK, 4% to Canada, 3% to Sweden, about 1% each to Denmark and Australia, and only 3% to the US.



This fund is also up nicely from a low of $9.45 in early July 2001 to $12.33 on Dec 27, 2002 — the beginning of what I believe could be a very significant rise. For more info, visit www.americancentury.com, click on "Fund List," scroll down to "Income" and then click on "International Bond." Or call 1-800-345-2021.

Like the Prudent Safe Harbor Fund, it has the overwhelming bulk of the portfolio (91%) in government securities. But instead of investing the rest in gold shares, this fund puts the balance in corporate bonds with a minimum rating of AA. I don't like corporate bonds

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The Weiss C
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Our Crash Protection Strategy comb
puts (see instructions on page 7) with zer
in our last issue and at www.safemoney
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the LEAPS are bound to surge as the ma

Larry Edelson's

mr. speculator

More Bear Market Profits In 2003

When markets are rising, it can sometimes take decades to accumulate significant wealth. But when markets are falling, you can often make similar profits in a much shorter period of time by using *bear market investments* — those that are specifically designed to profit from the decline.

Bear market investing is still a speculative risk — you lose if the market goes up. But right now, if you have risk funds available, I believe the risks may be worth taking because:

1. *You may need a hedge.* Do you have other investments that are vulnerable to a dramatic market decline — stocks you're unwilling or unable to sell, real estate you can't get out of, business assets you must own? If so, it may be imprudent *not* to own at least some bear market investments as a hedge.

2. *Most of the bear market investments we recommend have built-in risk limitation features.* You will never get a margin call, and you can never lose more than you put up. The only exception: Short sales, which is why we recommend stop losses with each and every position.

3. *The bear market is no longer just a future possibility.* It is here and now. The Dow, the German Dax, and the British Footsie index have been going down for three years. The Japanese Nikkei has been mostly falling for a full 12 years!

4. There's no bottom in sight. These massive declines are bound to continue until there is a fundamental change in the world economy ... and right now, no such change is on the horizon.

So, *it is not too late to start now.* If anything, the latest bear market rally gives you what we consider a convenient entry point. Follow these steps:

Step 1. Evaluate the risk you are taking with vulnerable assets. Each stock or property is different, but as a general guideline, you can assume about 50% risk in most common stocks and real estate — too much to ignore or just wait out. If you saw a boom in the value of your assets during the 1990s, you may be exposed to even greater risks. If your assets did not go up that much in boom times, your exposure may be less.

Step 2. Decide how much you want to protect. It's usually not prudent to hedge your *entire* portfolio. The hedges themselves involve risks, and they can rarely be perfectly matched to the precise assets you own.

However, it may make sense to protect up to half of your vulnerable assets. Let's say you have a stock portfolio worth $60,000. My best advice would be to sell it all — immediately. But if that is not possible, can you at least liquidate one-third? If so, you will have $40,000 remaining in your stock portfolio and $20,000 available for bear market investments, giving you protection on half your remaining portfolio.

Step 3. Learn all about reverse index funds. These are similar to index funds (matched to a particular stock market index like the S&P 500 or the Dow Jones Industrials) but in *reverse.* In other words, the more the market falls, the more money you make. And conversely, if the market rises, you lose.

Step 4. Match the reverse index fund to your portfolio:

* If you have mostly blue-chip stocks, or a mix of Nasdaq and Dow stocks, you can use the **Rydex Ursa** fund **(RYURX)**, which is designed to appreciate 10% with every 10% decline in the S&P 500.

* If you have a high concentration of technology stocks, you can also use the **Rydex Arktos** fund **(RYAIX)**, designed to appreciate 10% with every 10% decline in the Nasdaq 100.

(continued on page 8)

eiss Crash tion Strategy

Strategy combines a balance of LEAPS page 7) with zero-coupon bonds (detailed ww.safemoneyreport.com). If you're on , stick with all of the positions, with no s. The zeroes have appreciated nicely, and surge as the market falls.

Mr. Speculator

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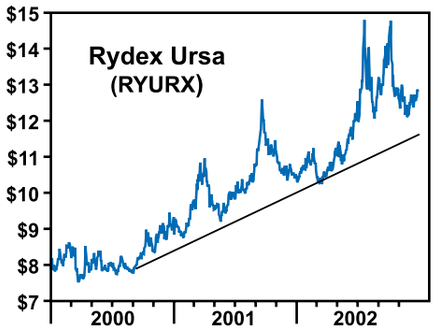


This fund goes up when the S&P 500 goes down; and, conversely, it falls when the S&P 500 rallies. Right now, we believe the timing is right to buy its shares, for two reasons: First, due to the confirmed, long-term bear market, Ursa has been in a steady, long-term uptrend. This trend doesn't guarantee success, but it should add to your confidence level that you're on the right track. Second, in response to the bear market rally that began in October, the Ursa shares have taken a dip, lowering your entry price.

* If you would like to allocate a lower dollar amount to hedging, you can use LEAPS put options (more on these in a moment).

* If you are completely out of the stock market, you can use bear market investments strictly for speculative profits. Just be sure to limit your investment to funds you can afford to lose.

If you're hedging or speculating strictly based on our advice in *Safe Money*, our prime recommendation is the Rydex Ursa Fund. Since it reflects the S&P 500, it effectively gives you the broadest diversification and is less volatile than other funds in its category.

Portfolio Update

Citibank (C) short. You should be short since November with an entry price in the $37-$38 range. Give your broker instructions to take profits at $31 or lower. Plus, to reduce your risk, lower your stop-loss to $39.50. New subscribers: Focus your attention on Rydex Ursa for now.

Target (TGT) short. In December, we warned about disappointing retail sales and told you to short this stock, one of the weakest due to the rising default rate on its credit card portfolio, now totaling $5.2 billion. Right on cue, other analysts began to wake up to Target's credit card problems, and by the end of the month, the news began to hit about the weakest holiday sales in decades.

Result: The share price plunged from about $33.20, where you could have shorted the stock, to its most recent low of $27.62. Take profits at $25 or lower, with a stop-loss at $34. New subscribers: Focus on Ursa.

LEAPS put options. The market rally has depreciated these long-term options, but as the rally fades and stocks make new lows, the LEAPS puts should recoup their previous highs and beyond. So hold all previous recommendations. If you are a new subscriber, buy two contracts each of the **S&P 500 Dec 2003 LEAPS 80 puts (LSX XY),** currently trading at $6.10 (or $610 per contract) and the **Dow Dec 2003 LEAPS 76 puts (DJX XX)**, currently trading at $6.30 (or $630 per contract). Please note that the ticker symbol on this LEAPS put has changed, as has the ticker symbol for the **Dow Dec 2003 LEAPS 80 puts (DJX XB)** that some subscribers are holding.

How To Buy These Bear Market Investments

How to buy Rydex funds: Call 1-800-820-0888 or open an account online at www.rydexfunds.com. The account minimum is $25,000, although you can meet the minimum with a combination of various funds they offer.

Or, you can buy with lower minimums through brokers, as follows: Fidelity Investments (800-343-3548, minimum $2,500), TD Waterhouse (800-934-4448, minimum $1,000), Charles Schwab (800-435-4000, minimum $2,500), or one of the other brokers listed on the Rydex website.

Due to their relatively low level of investor complaints, we favor Fidelity Investments. For more details on this analysis, see issue #339 (archived on the *Safe Money* website at www.safemoneyreport.com).

How to buy LEAPS puts: LEAPS can be purchased through your usual broker. The recommendations in Mr. Speculator are based upon a Reduced Value index. For the Dow Jones, for example, the regular index is divided by a factor of 100 and is known as the DJX, which trades on the CBOE. It simply uses the real Dow Industrials as its basis. The S&P 500 index has its own "reduced value" index — symbol LSX — which is specifically for the LEAPS products. For more information on LEAPS and how they work, check www.cboe.com/LearnCenter/Basics.asp or see www.safemoneyreport.com/invest/leaps.asp.

Gold Surge Just Beginning!

Larry Edelson

Nearly all of the powerful forces I described for you in issue after issue throughout 2002 are converging in one time and place.

The place is the world market for gold bullion. The time — right now.

The forces? Limited supplies. A major decline in sales by central banks. Greatly reduced hedge selling by mines. Plus — most dramatic of all — surging investor demand!

Investors are seriously concerned about a sinking economy and its unforeseeable financial consequences.

They are worried about the collapse of Japanese banks, including some of the largest banks in the world.

They are disgusted with three years — and more — of bear markets in every major stock market on the planet.

They are frightened about untold, possibly imminent, disasters in Venezuela, the Persian Gulf, the Korean Peninsula.

Even if some of these crises are resolved, no one can reasonably expect *all* of them to go away. And even if just *one* blows up, it could drive investor demand for gold through the roof.

Next Target: $360, Then $375, and Next $400 or Higher

In December, while many traders were on vacation and most investors were looking the other way, gold surged $11, busted through $348, and then hit $354, before settling back down into the mid-$340s.

But the December gold surge is just the beginning.

My next target: $360. Right now, you should expect gold to take a breather, and meander back and forth at the $335 to $345 level. But that won't last long. With gold mining companies actively reducing their hedges and tensions increasing with Iraq and Korea, I expect gold to soon thrust higher again, to the $360 level.

Then expect $375. Recently, I received technical confirmation that the dollar's seven-year uptrend has been busted. Now, I see it falling 20% this year and perhaps more. The falling dollar will attract *more* speculative buying of gold, helping to push gold to $375 and higher.

Ultimately, I see $400 gold or higher. There is no question in my mind that's where gold is headed. Years of depressed gold prices caused several mines to run down production or stop altogether. But now as prices soar, some producers find themselves unable to meet demand. That's because they can't just turn on a tap and let the metal flow. It takes months and even years to get back into the full swing of production.

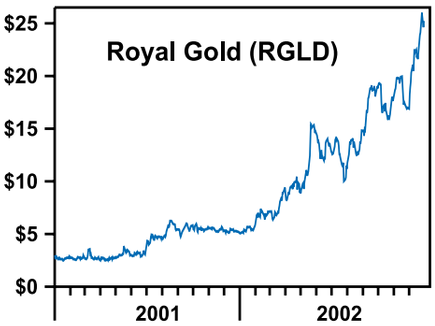
Now, the gold market across the globe is set to be in short supply for years to come. With physical demand for gold jewelry in China also exploding, and the very real gold-backed Islamic dinar coming soon, coupled with panic buying in Japan and nearly every other part of the globe, the bull market in gold is here for years to come.

Portfolio Update.

Anglogold (AU) is up 22% since I recommended it last month. In December, the company raised $600 million through the issuance of new stock, which it may use in the future to acquire other producers. A great move in my opinion.

Durban Roodepoort Deep (DROOY) is up 23% in December and headed higher.

Likewise, **Royal Gold (RGLD)** is up 39% for the month (see chart). It has completed the acquisition of High Desert Mineral Resources in a cash and stock offer for a 93.5% stake in the company. Great move.



(continued on page 10)

Gold Surge
(continued from previous page)

Agnico Eagle (AEM) is up 27% in the past month. The company announced a 50% increase in the dividend payable in March 2003 for existing shareholders. Their continued success comes on top of an expanded rate of production at its LaRonde mine. Shares rallied from $11 to close the year at $14.86.

Newmont Mining (NEM) is up 17% for the month. In fact, Newmont was the S&P 500's third-best performer in 2002, with a 53% gain. Its hedge-reduction strategy has enabled it to benefit tremendously from gold's new bull market.

Glamis Gold (GLG) is up 36% in a month's time. And it's headed much higher.

My advice is simple: If you own these shares, hold. If not, buy at the market.

Cover Story *(cont. from p. 5)*

Countless others play tricks in how they report high-risk derivatives.

Worst of all, *most of America's largest companies are still grossly overstating the future value of employee pension funds and underestimating how much they will have to contribute to these funds to make up for the shortfalls.*

Last year, I told you that at least 234 companies in the S&P 500 owe a whopping $78 billion to their employee pension funds. Plus, I demonstrated how nearly half of all the companies we analyzed were using the paper profits in their pension funds to artificially goose up their bottom line.

Well, now it's worse. The stock market has fallen further. Their pension funds are deeper in the red. They owe more and they will take bigger hits to their profits. For example ...

* General Motors recently admitted that, due to the decline in stock markets and the fall in interest rates, their $12.7 billion pension fund deficit will swell to $14-$17 billion by 2006. And that's based upon today's assumptions! What happens if they're overstating those assumptions?

* IBM has no choice but to reduce its estimates of the expected returns in its pension plan.

* Nearly every company I cited last year for its pension fund underfunding (see issue #341 in the archives section of www.safemoneyreport.com) is in worse shape now than it was then.

My forecast: In 2003, you will see some of the biggest hits to earnings ever, due to the reluctant recognition that they are falling further behind in their ability to meet pension fund obligations. Their stocks will plunge again.

My advice is the same: Get out of the stock market. With the exception of the select gold shares we recommend, clean out your portfolio. Sell everything. Don't wait. Soon, today's stock prices will seem very high, and you will regret having missed the opportunity to sell at these levels.

If selling now means taking a loss, so be it. These losses are historical facts. You're much better off recognizing them and moving on.

If selling now means taking a profit and writing a check to the IRS, so be it. The only way you can save money on those taxes is by letting your profits turn to losses — not exactly a rational investment strategy.

Forecast #7
The real estate bubble will pop!

The price of the average American home rose more quickly in the last seven years than in any previous period since 1945 — when the GIs came home from WWII and drove housing prices skyward. Now this bubble is about to pop, and 2003 could easily be the year.

Reason #1. Americans can no longer afford to buy overpriced houses. Roughly 13.9% of household expenditures were allocated to housing costs in 1951. By 1995, that number had nearly doubled to 26.8%. Today, many homeowners spend 50% or even *more* of their take-home pay on their mortgages!

Reason #2. Mortgage delinquency rates are hitting record highs and banks are tightening up on credit.

Reason #3: Americans are already tapped out. In the 1940s, the average American family had more than 85% equity in their home. By 2001, the average equity had plunged to 55%, with millions

down to practically zero in equity. That means it is becoming increasingly difficult for Americans to "trade up" and buy the new overpriced homes.

My forecast: As housing prices begin to decline, much of the remaining equity will disappear, encouraging still more homeowners to sell. Real estate prices could fall off a cliff.

My advice: Don't be complacent. Avoid investing in real estate. If you have a significant portion of your assets in your home, and you have other living alternatives you'd be happy with, consider cashing out while prices are still high.

Forecast #8
Some of the largest banks in the US will suffer severe losses in 2003.

When the economy falls, most banks suffer rising loan losses. That's what's happened in the past three years, and what's bound to happen again in 2003, on an increasing scale.

In addition, seven of the largest banks in the U.S. are more vulnerable than ever to derivatives failures: J.P. Morgan Chase has total derivative positions in excess of $26 trillion — or more than 2.5 times the entire gross domestic product of the United States. Bank of America has $11.5 trillion; Citibank, $7.8 trillion; Wachovia Bank, $2.3 trillion; and Wells Fargo, $1.1 trillion. All told, 408 US banks have derivatives with a total "notional" or face value in excess of $53 trillion!

Granted, these "notional" values greatly overstate the actual risk involved. But according to the latest data from the Comptroller of the Currency, J.P. Morgan Chase has $6.28 in derivative exposure for each dollar of its risk-based capital; Citibank has $1.97; and Bank of America, $1.94.

That's insane! And if you think derivatives can't sink a major bank, tell that to shareholders of Britain's venerable Barings Bank, which was driven to bankruptcy in February 1995 by derivatives trading.

My forecast: Expect rising bank failures in 2003, including severe strains on some of the largest. When a bank fails, shareholders will lose almost everything. Holders of debentures will suffer losses in excess of 50%. And depositors will lose up to 100% of their uninsured portions.

My advice: Sell all bank shares immediately — whether at a profit or a loss. Avoid all banks with a Weiss Rating of D+ or lower. (The strongest and weakest banks in the country are listed at www.weissratings.com/HL_Bank.asp.) Move your savings, whether insured or not, to banks with a Weiss Rating of B+ or better, or to US Treasuries or equivalent.

Bottom line: To prosper in the New Year, keep most of your money in the safest, most liquid investments in the world.

Mr. Conservative
(continued from p. 6)

right now. But if you put 5% of your money in this fund, and it has only 9% allocated to corporate bonds, that means you'll have no more than about a half percent of your money in corporates, all high grade. That's too small to be an issue.

Step 3. If your portfolio is small, allocate 10% of your money to just one of these funds. I have a slight preference for the Prudent Safe Harbor fund, but both funds are recommended and should do well.

Step 4. To buy the above mutual funds, reduce your Treasury-bill allocation from 60% to 50% of your conservative portfolio. The yield on T-bills is now *even lower* — down to a pitiful 1.20%. But with nearly all other investments falling or vulnerable to a big fall, that's a small price to pay for complete safety and liquidity. Moreover, we have successfully offset the low yields with excellent gains in the rest of the portfolio.

Step 5. Hold your 3-5 year Treasury notes (20% of the portfolio). Many subscribers are holding notes yielding about 4% or more, and have also enjoyed a price appreciation of about 3.25% since May 2001. Stick with them. If you are a new subscriber, you can buy the 3% note of November 2007 (yield 2.67%) through most brokers.

Step 6. Hold your Enerplus Resources Fund (ERF) (10%). While the price of this closed-end fund has been holding nicely within a narrow range, it continues to yield about 12% annually. Not bad! New subscribers: Buy at the market, with a protective sell stop at $14.85.

Step 7. Follow Larry's instructions on page 9 regarding your gold shares, maintaining your 10% allocation.

PROFESSOR INVESTOR

Special Questions From Our Readers

Q: In one of your e-mails, you mentioned 59 companies that are vulnerable to bankruptcy. Will you send us their names?

A: Of course! Check your mailbox in about two weeks.

Q: A financial planner told me that variable annuities are a good place to put my IRA funds instead of cash or government securities. Transamerica was the company he mentioned, with guaranteed 6% and guaranteed principle, etc. What do you think?

A: With so many changes on the immediate horizon — some of which may have the potential to change the face of investing for decades — I generally advise against anything that locks you in with large commissions or fees.

Unfortunately, however, that happens to be the norm for nearly all annuities. For example, Transamerica's 6% deal requires that you buy still another product that locks your money away for 10 years.

Yet, there still may be a place for annuities in your plan, depending on your personal goals. For more information on annuities, see the Weiss Ratings' *Consumer Guide to Variable Annuities* (To order a copy, go to www.weissratings.com/Products/LH_annuities_guide.asp or call Weiss Ratings at 1-800-289-9222

Q: I own a little gold per your advice, but after seeing gold move up like a rocket over the last several days, I am seriously thinking about putting several hundred thousand in gold mining shares. Problem is, the technical indicators indicate the gold mining shares are overbought and due for a pullback. What should I do?

A: The decision on how much to buy is up to you, but generally I recommend that investors limit overall gold-related holdings to about 10% of their total investment portfolio. So, first, review the amount you are allocating to this area one more time, adjusting it as needed. Next, divide that amount into three equal portions, investing one-third now. Then, invest the second third after a pullback — whether from current or higher levels. Save the last third for adding to the position once it is clearly in winning territory, again, after a future pullback.

Q: What is your opinion on buying bank CDs? What time period do you recommend?

A: I still prefer Treasury-only money funds. But if you insist, I recommend you stick with CDs under one year from banks earning a Weiss rating of B+ or better.

For example, Advanta Bank Corporation (Utah) is rated A- by Weiss Ratings, and is paying 2.55% for a 12-month CD. Also, Newton Bank of New Jersey, rated B+ by Weiss Ratings, pays 1.89% for a 12-month CD. Somewhat better than Treasury yields? Yes. But you also have to factor in some disadvantages: Unlike your Treasuries, CDs are not exempt from local and state income taxes. Plus, if you want out ahead of time, you pay an interest penalty.

Q: I own Kmart bonds, which have fallen from $114 to $26. Should I sell and take the loss or wait until it comes out of bankruptcy?

A: Sell. Kmart may never come out of bankruptcy. Even if it does, your bonds may not be worth significantly more than they are today.

Q: On October 28, 2002 you sent out an email "S&P confirms Weiss warnings!" How can I get a copy of the report?

A: Go to the S&P website at www.standardandpoors.com. Click on "Standard & Poor's Core Earnings" under the heading "Special Coverage." Then select "Standard & Poor's Core Earnings Market Review" under the heading "Latest Standard & Poor's Research." If you do not have access to a computer, call 1-800-523-4534 and request the October 24, 2002 report titled "Standard & Poor's Core Earnings Market Review."

Q: You keep saying the market is going to tank anytime. But the way I see it, the market is not reacting to any of the bad economic news. Do you think it's because of the growing political power of the Bush Administration?

A: No. This is a temporary, technical rally — nothing more. The Bush Administration may be achieving political victories. But I don't think anyone — whether Democrat or Republican — can avert the economic decline already on the way.