INSTITUTIONAL ADVISORS

OCTOBER 4, 2004

INTERNATIONAL OUTLOOK

Our long-time colleague, Tom Peterson (www.bullseyeresearch.com), put together a key update on the international markets he covers. Let's call it timely and clinical.

Tom's concerns about Japan's stock market and business activity seem to be confirmed by an October 3 release by the Bank of Japan. As Bloomberg reported it today:

"***BOJ to Keep Easing Monetary Policy and Deflation***"

Governor Toshihiko Fukai

"***Nationwide core consumer prices fell 0.2 percent in August. Core prices rose in just one month from year-earlier levels since April, 1998***."

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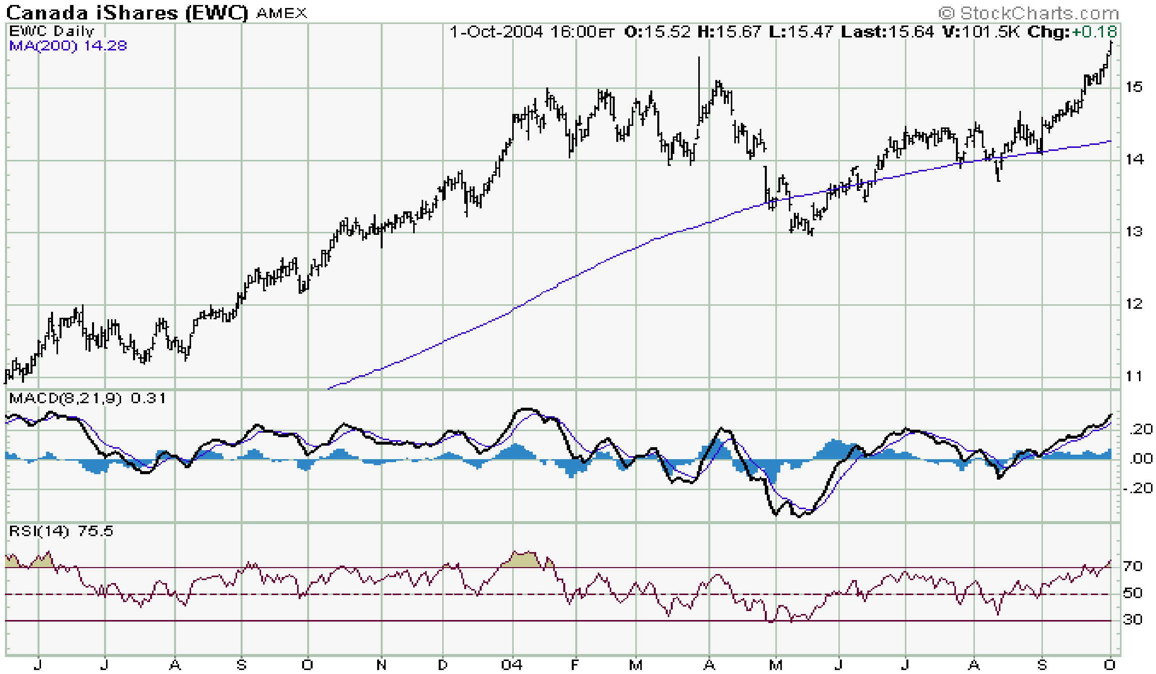
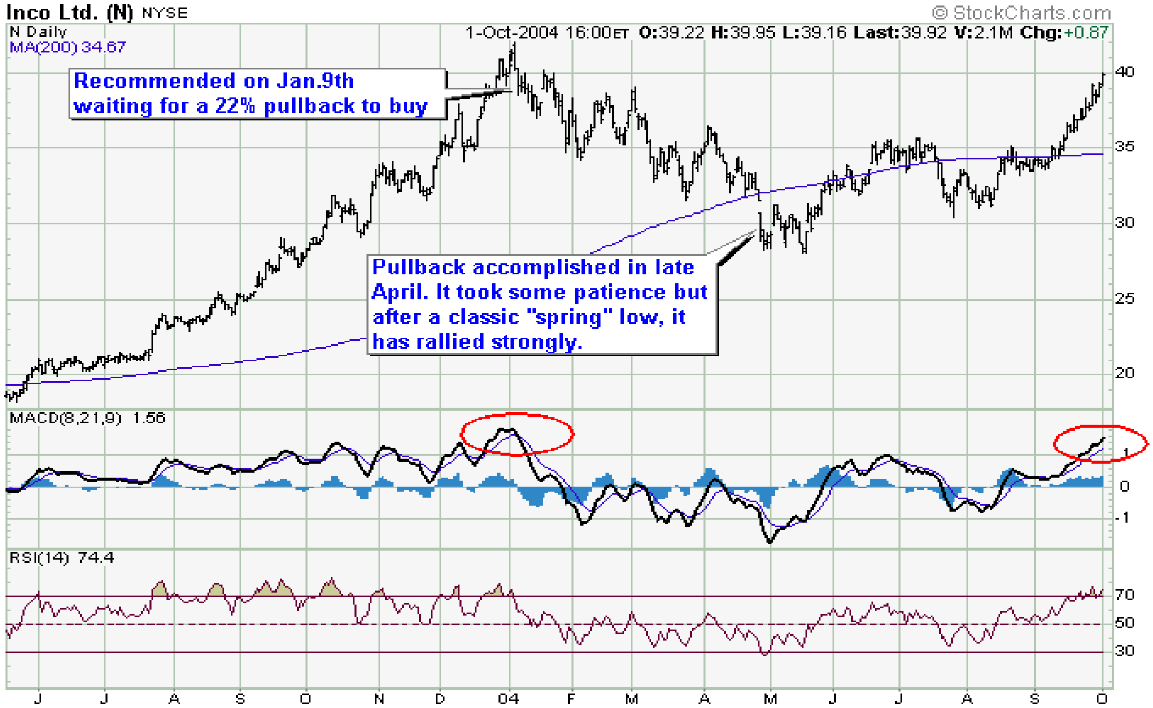
OH CANADA



Oh Canada: The Canadian market broke out recently, as shown by the I-shares above (EWC). The Canadian dollar has been very popular, and bolstered by not only an improving fiscal situation but also because investors continue to seek out commodity-based investments. It has been several years now since we originally proffered the idea that a return to out-of-favor energy & commodities might make the most sense for a conservative investment strategy – now commodities are into the exponential stage of advance and what was once a conservative sector is now beginning to look frothy (but not yet terminal).

The relative strength line, along the bottom of the chart, is getting into a short-term overbought condition as evidenced by the RSI (14) line moving over 70. That indicates they may have to undergo consolidation or pullback short-term. The overall uptrend, however, looks promising. We think that after a pullback, which should end anywhere from late October to mid-November, that Canadian mining shares could get even more explosive. If you recall, we recommended Cameco shares on January 30th, 2004 - Cameco (below) is a Canadian mining company play on uranium and also copper. It trades sporadically as CCJ on the NYSE; it's more active on the TSE as CCO. Cameco is now getting to a point where a pullback/consolidation could be expected. But until Uranium becomes a household word, we think there is more upside possible

Likewise, in January we also recommended buying **Inco (N)** after what we anticipated would be a 22% correction (this was accomplished by late April).

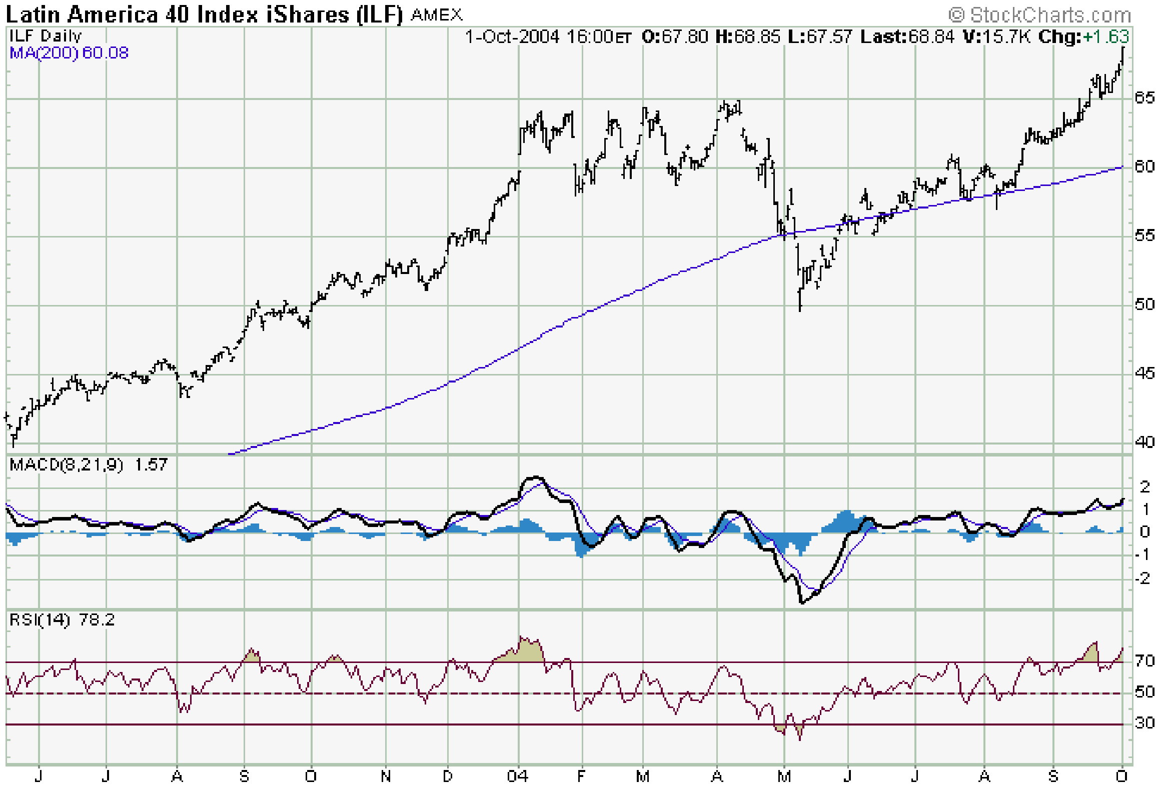


Now Inco is testing its high, while RSI and MACD oscillators are getting pretty overbought. We think profit-taking on Inco is in order. The outlook for base metals from here is not as robust as that for energy.

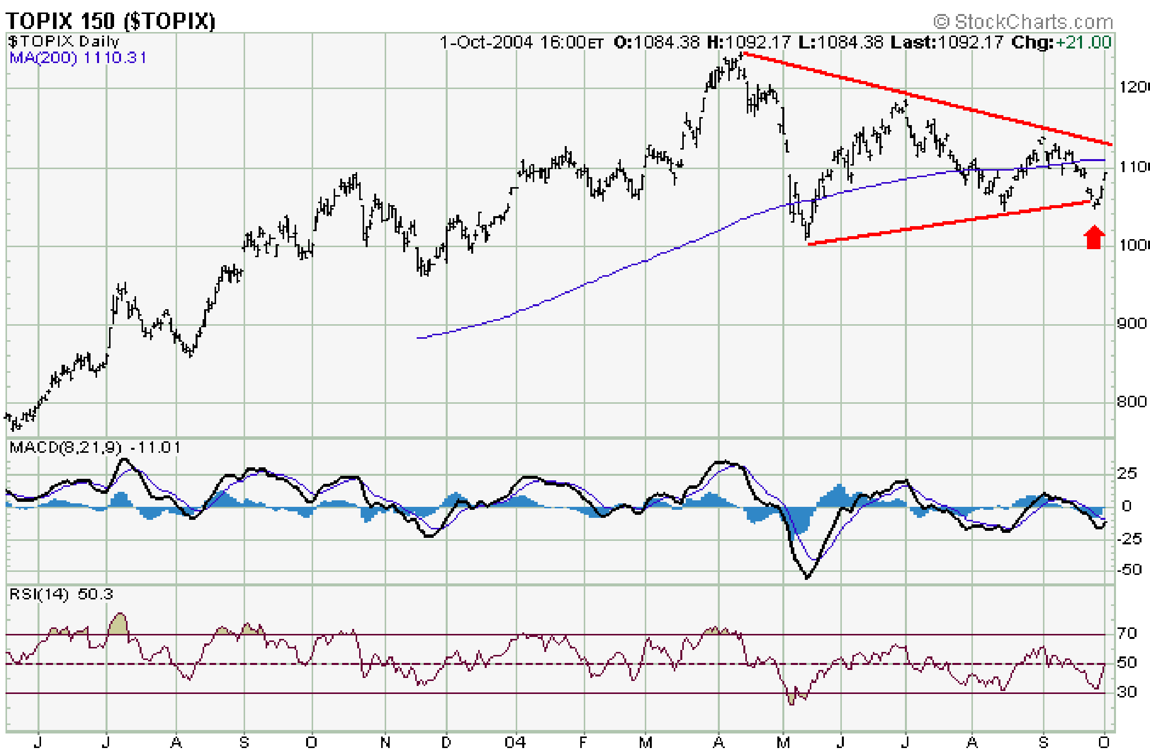
Another uranium producer is **Denison Mines (TSE:DEN),** which has doubled from the August low and may be ready for a decent correction. The breakout to new highs occurred at $8.23 so it becomes a natural support area. A 50% correction of the rally also comes into play at $8.17. The ADX Indicator (a strength of trend reading) is at 50. Historically, markets tend to correct back to the midpoint of the 20 & 50 day moving averages once the ADX rolls over from such a level. The averages are currently at $8.50 & $7.38 and rising. Therefore, if prices decline reasonably quickly we could easily be approaching the $8.25 level. If the correction is more of an A-B-C style then the averages will likely come up to kiss the price at a later date and higher level.

For the next few weeks we would look to enter on a scaled basis starting at $8.50. If the correction has not truly commenced in a few weeks, it will be necessary to revise the buying levels at a later date.

LATIN AMERICA

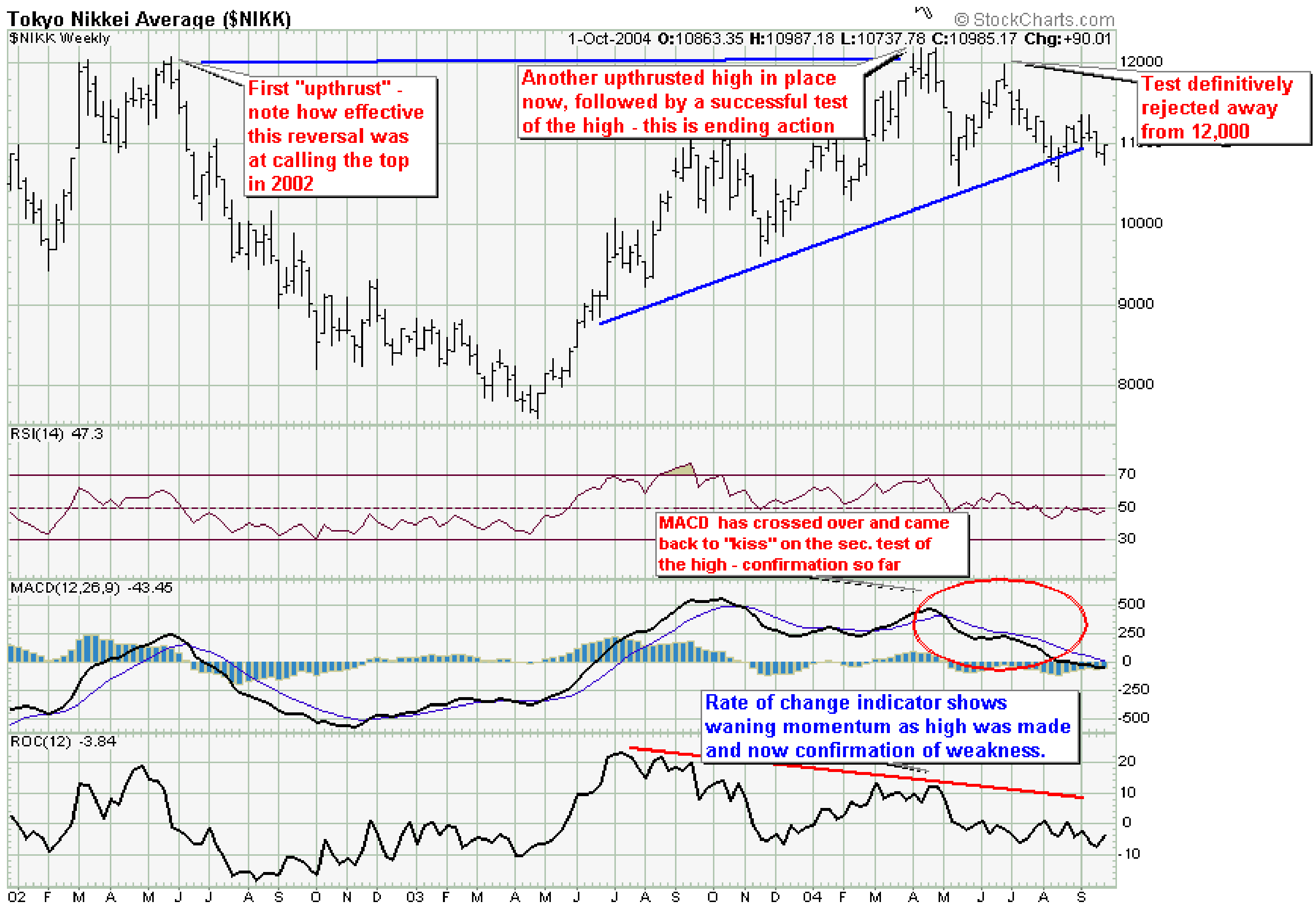


Latin America: also hit a new high for 2004. Latin America is currently the strongest region in the world (see chart above for the Latin American 40 Index iShares ILF). As in the case of Canada, Latin America is also being helped by rising commodity prices since the region is a big exporter of oil and other commodities. The rising relative strength line shows that Latin America has been outperforming the U.S. since May, but it is now faltering, with a potential negative divergence developing. Also, as in the Canadian i-shares, the RSI line over 70 shows that the region looks over-extended on a short-term basis.



JAPAN

Japan's Topix: Struggling to stay inside the big pennant it has formed since April. The 200-day m.a. is still rising so it has a chance to resolve itself to the upside.

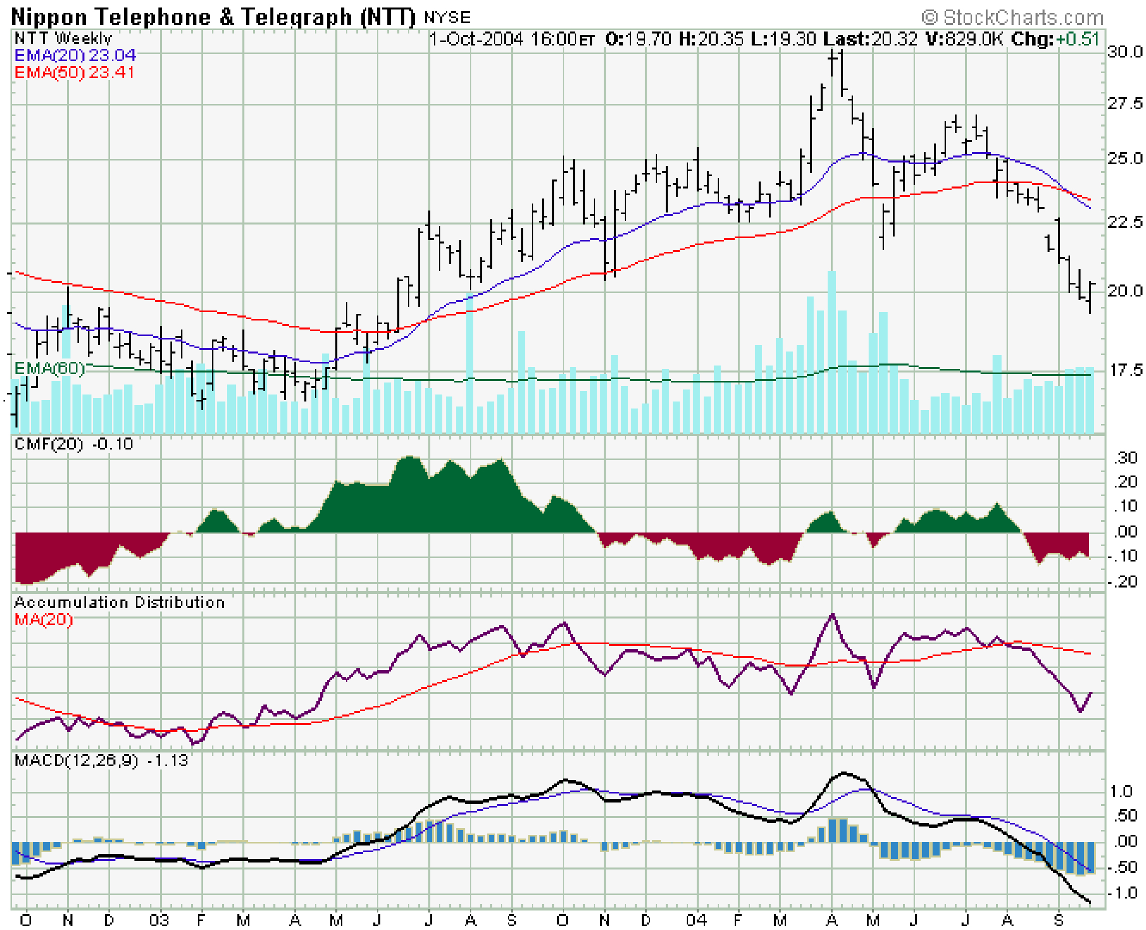


Japan: Japan has been hurt by the huge rise in the cost of energy, particularly oil. Rising oil prices are compounded for Japan because the Yen is weak relative to other currencies including the dollar. We have seen weakness over the past few months in Japan's economic statistics as well. The latest Tankan Survey was released Friday and the media were quick to jump on the headline rise, as the key index measuring large manufacturers' sentiment rose to a 13-year high of plus 26 in September from plus 22 in June, beating the economists' average forecast of 23 compiled by the Nihon Keizai Shimbun. The index represents the percentage of companies reporting favorable business conditions less those reporting unfavorable conditions. But, not so fast – this is soft data after all. How does the other recent hard data compare?

What we see is that consumers are retrenching again - average spending was down 2.5% during the month of August, which moved the year-over-year rate back into negative territory, to - 0.4%, a huge drop from July's +2.7% YOY gain. What was interesting was the "propensity to consume" rose from July's 71.0% reading to 75.4% for August. Since average spending fell, but spending in relation to incomes rose, it implies there was a significant drop in average earnings. This is backed up by Friday's report showing September domestic Japanese automobile sales fell sharply, marking the seventh decline in the last eight months. The latest sales data also fosters the same conclusion, as Retail Sales fell more than expected in August, down 1.8% y-o-y, following July's small +1.0% increase. Large Store Sales dropped 5.4% y-o-y, plunging further from the 1.5% y-o-y decline posted in July. The drop in final demand is backing its way down through the supply chain, as we see Wholesale Sales dropped 2.6% for August, taking the y-o-y growth rate to +5.0%, down significantly from July's +6.2% tally.

On a broader front, it is also not encouraging to see New Export Orders came in at 51.7, down a substantial 3.2 points from August's 54.9 reading, and well below the three consecutive readings above 55 posted in each of the three previous months. This is exacerbated by rising inventories, as exemplified by the latest Industrial Production figures which showed inventories up 2.0%, nicely correlating with the data showing shipments dropped 2.1% *(continued next page).*

What Japan needs to climb its way out of this multi-year downward spiral – for good – is to combine export growth with rising domestic demand. The Japanese are notorious savers, of course, because they do not have the benefit of the kind of social safety net the West is blessed/burdened with. They have to be more self-sufficient than we are. So to nudge them into stepping up consumption, they will probably need to have rising incomes. And one can argue that rising incomes can only be permitted if manufacturers and distributors of goods can enjoy rising pricing power which can generate the 'price push' side of the equation. But just as in the 'decadent' West, pricing power is not present. This is illustrated by the latest Japanese Purchasing Manager's Index (PMI) report for September, showing Output Prices rang in at only 48.9, down from August's 50.5 data point; this makes September's the fourth monthly reading in excess of the 50 level in five months. In addition, Japan's reflation efforts are shown to still be ineffective by the latest CPI readings which indicate September was the third consecutive month with no change, and keeping the year-year core-CPI rate into outright *deflation*, *posted at minus 0.1%.* So with respect to the question of whether the Japanese will hike rates in the near future, the answer has to be NO. With respect to currency, it means the US dollar can continue to be more favorable than Yen, which helps answer the question of whether the Japanese will keep helping the US cover its current account gap down the road (if not near-term).



With all this data coming from Japan this week, in advance of the G7 meeting, we thought it timely to make note of our old friend Mr. NTT. **Nippon Telegraph and Telephone (NTT)** announced Friday was that they are cutting prices to stimulate demand for fixed-line service, for both residential lines & business lines; and also long distance. Once again, a data point suggesting that reflation is not gaining as much traction as hoped for in Japan. Fundamentally, we still like NTT's assets and growth prospects. Technically, we didn't quite catch the top in our last sale recommendation, but now the stock has round-tripped back to its old buy territory - it broke out from this area in June 2003. NTT appears to be in the third wave down; if this is an ABC correction it should stop soon, but this decline looks not quite over yet. One could nibble here, but it may have to consolidate between $17 ½ and $21 before a new advance can begin in earnest.

Since we opened with words about the Tankan Survey headline, let us close this topic with a portion of the survey the media downplayed. While the current situation index rose better than expected, the *expectations* for Q4-2004 show a plunge, with the December Expectation Index coming in at *minus 1*. In other words, a decline of 3 full points is anticipated for the next three months by Japanese big business.

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