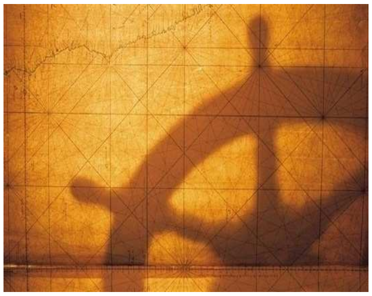


The Starboard Side Report

The week ending October 23, 2009

Cash yields of zero percent and a falling currency are forcing US investors into riskier assets such as high-yield corporate debt, equities and commodities. This is exactly what the Federal Reserve was trying to accomplish when it slashed the federal funds rate to nothing last year. The main problem is that it's the government and not the private sector that is causing this latest asset boom. Money printing and the resulting currency debasement can only take us so far because it will ultimately destroy the purchasing power of US consumers in the global economy. We believe that this new reality will eventually lead to a stall-out in the debt and equity markets on a relative basis versus inflation hedges such as precious metals and commodities. One way to look at declining US prominence on the global stage is to analyze how our stock market is performing when priced in other currencies. The first chart below shows the S&P 500 from a European perspective. Things don't nearly look as cheery across the pond. The chronic underperformance this decade is having a slow and grinding effect on the willingness of foreigners to invest here. This matters because foreign capital helps to sustain bull markets. This motto is especially true at present for the US given the capital constrained state of our consumers.

S&P 500 Priced in Euros

Another way to look at the loss of US purchasing power is by viewing the S&P 500 priced in hard assets such as gold and commodities. These next charts below are illustrative of just how poorly US stocks have performed against inflation hedges over the past ten years. Unfortunately, the evidence points to even more dramatic declines in the decade ahead. In 1980, the old cycle low for the S&P to gold ratio is all the way down at 0.13 (still 87% below the current level). The news is equally as dreadful for US stocks versus the CRB Commodity Index. This ratio must fall another 83% to get even to the price parity that existed between stocks and commodities in 1980. We can not emphasize enough the importance of studying these historical asset class cycles. US paper assets as defined by the S&P 500 are in a *major* long-term downtrend versus hard assets. This is also the point we were trying to make in our last report by charting the value of US gold reserves versus the money underlying them in circulation.

S&P 500 Priced in Gold

Only a 37% rally since March in these terms. The prior cycle low of this relationship is all the way down at 0.13 in

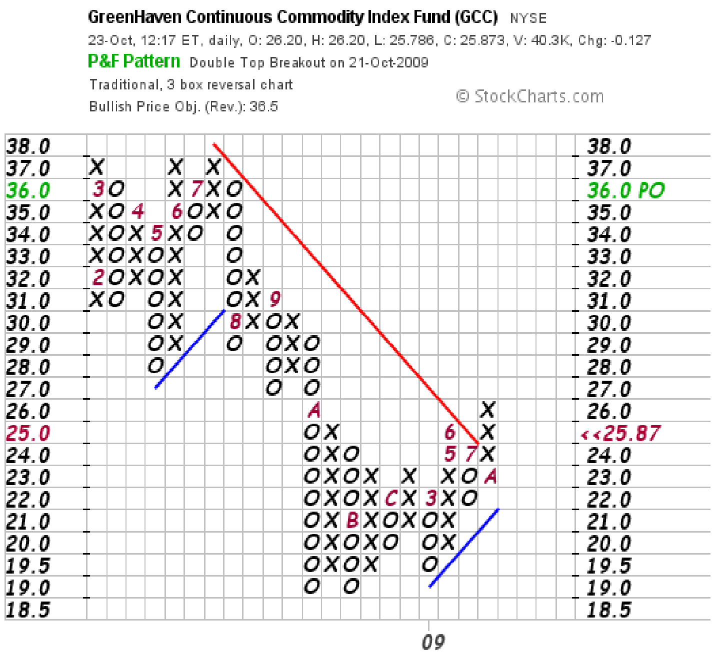
S&P 500 vs. CRB Commodity Index

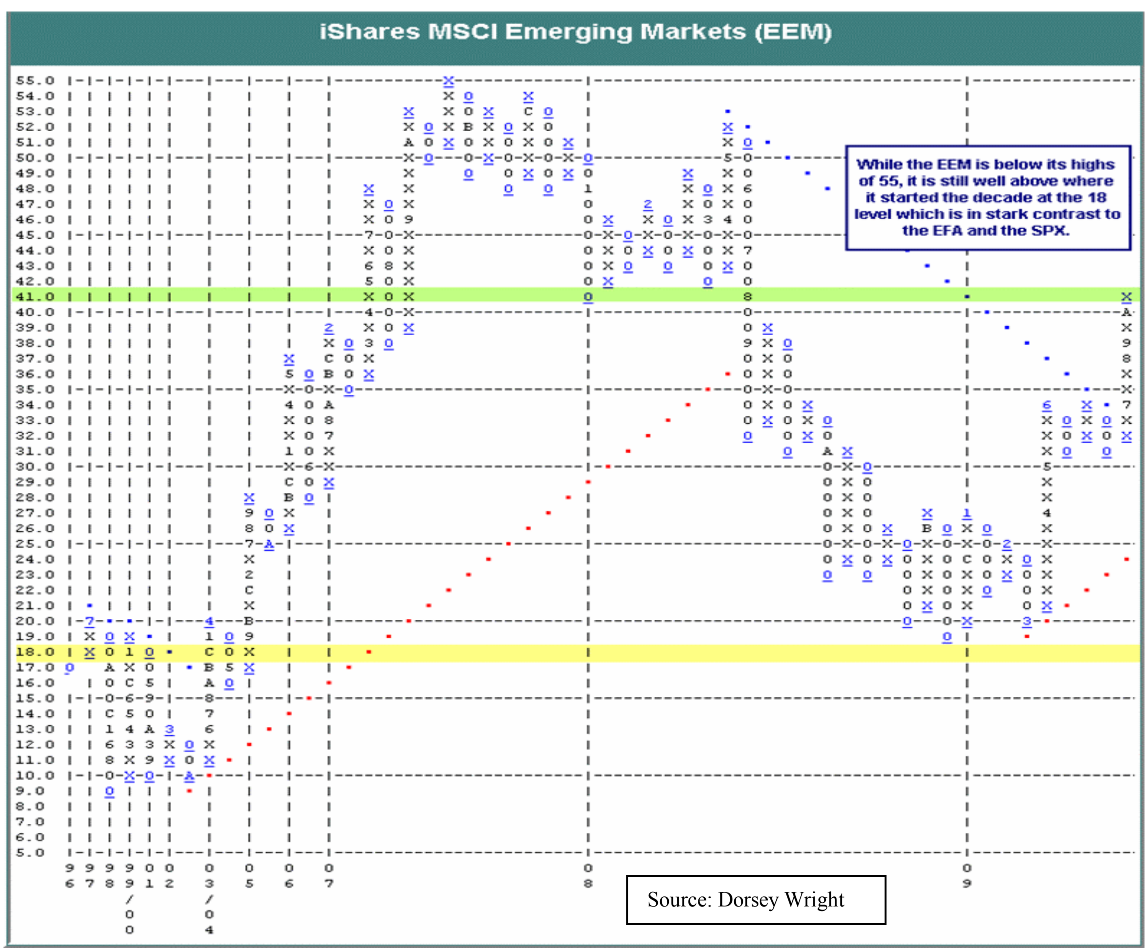
Still need a 46% compression in the ratio to get back to the 1990 relationship. The prior cycle low of this relationship is all the way down at 0.38 in 1980.

Only an 18% rally for the S&P 500 since March in these terms.

Most of the paper gains that US stocks have experienced off of the March bottom have been an illusion fostered by a major decline in the value of the US currency. This is the recipe the Federal Reserve will be using in the years ahead and unfortunately it is a recipe for a decline in our living standards relative to the rest of the world.

Despite our views on the long-term structural troubles facing the US economy, we are in a window of opportunity to profit from the Federal Reserve's desire to lift all asset prices through monetary stimulus. Calling exactly when this artificially induced feel good environment will wear off is a tough call, but our best guess is we might have until the middle of next year. We have tried to lay out in recent reports that the market internals are very strong right now and stimulus is still plentiful. Historically, markets do not peak with such strong momentum. The seventh inning stretch may be a fitting analogy for where we stand in this bull market cycle. More choppy upward consolidation over the next few weeks before one final big move higher into the end of the year or through the first half of next year for some stronger sectors and countries. Two of those stronger areas are listed in the charts below. Commodities have just broken out of a four month consolidation and look poised to start a new leg higher. Emerging markets are a bit stretched in the short-term, but we believe this group may continue to attract meaningful capital flows even after the US market tops out. As you can see, this decade has been good to emerging market investors.





One final note this week is that the Asia Pacific Bullish Percent Index reversed back into X's after having been in O's since mid-August. This means buyers have now regained the upper hand from sellers. After leading the market higher with some explosive moves off the March bottom, many Asian stock indexes have lagged behind a bit since June. In most respects, they are still far above their European and US counterparts year-to-date, so we view this as a healthy consolidation, not a meaningful shift in relative strength. The reversal in the bullish percent is a positive development that may be setting the stage for another round of Asian leadership ahead.

Bullish Pct for all Asia Pacific Equities (BPASIA)
Updated Through- 10/23/2009 (56.171 Up 0.683)

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76        |                                   |                                       76
74        |                                   |                                       74
72        |                                   |                                       72
70  ------|-----------------------------------|-------------------------------------- 70
68        |                                   |           X                           68
66        |                                   |           6 O                         66
64        |                                   |       X   X O 8                       64
62        |                                   |       X O X O X O                     62
60  ------|-----------------------------------|-------X-O-X-O-X-O-------------------- 60
58        |                                   |       X O 5 O X O                     58
56        |                                   |       4 O X O X O X                   56
54  O     |           X                       |       X O X O X A X                   54
52  O     |           X O                     |       X O   O X O X                   52
50  O-----|-----------5-O---------------------X-------X-----7-X-O-X------------------ 50
48  O X   |           X O                     X O     X     O X O                     48
46  O X O |           X O                 X   X O     X     O X                       46
44  B X O |       X   X 6                 X O 1 O     X     O                         44
42  O C O 1       X O X O                 X O X O     X                               42
40  O-X-O-X-O-----X-O-X-O-------------X---X-O-X-O-2---X------------------------------ 40
38  O X O X O     X 3 4 O X           X O X O | O X O X                               38
36  O X O | O X   X O X O X O         X O X   | O X O X                               36
34  O X   | O X O X O X O X O         X O X   | O   O X                               34
32  O     | O X O X O X O X 8         X O X   |     O X                               32
30  ------|-O-2-O---O-X-O-X-O---------X-O-C---|-----3-X------------------------------ 30
28        | O X     O X 7 X O X       X O X   |     O                                 28
26        | O X     O X O   O X O     X O X   |                                       26
24        | O X     O X     9 X O     X O X   |                                       24
22        | O X     O X     O X O X   B O X   |                                       22
20  ------|-O-X-----O-X-----O-X-O-X-O-X-O-----|-------------------------------------- 20
18        | O X     O       O   A X O X       |                                       18
16        | O X                 O X O X       |                                       16
14        | O                   O X O X       |                                       14
12        |                     O X O X       |                                       12
10  ------|---------------------O-X-O-X-------|-------------------------------------- 10
 8        |                     O   O         |                                        8
 6        |                                   |                                        6
 4        |                                   |                                        4
 2        |                                   |                                        2
 0  ------|-----------------------------------|--------------------------------------  0
-2        |                                   |                                       -2
---      0                                   0                                       ----
---      8                                   9                                       ----
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Back to a column of X's means demand has regained control from supply for the first time since August.