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March 2007 *Issue #395*

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Mortgage Meltdown!

- **Why U.S. mortgage lenders are getting slammed! How some could go bankrupt.**
- **Why the shares of big banks could be the next to take it on the chin.**
- **Your solution: Hedge in the U.S and diversify overseas!**

The housing and mortgage crisis we've been warning you about is now unfolding in aces and spades, especially in the highest risk "subprime" sector. Just in the last few weeks ...

Fremont General, the nation's fifth largest subprime lender, was cited by the FDIC for 14 violations related to its mortgage business. Its operations were virtually shut down. Its workers were sent packing. And its stock plunged 32% in a single day; 70% since January 2006.

New Century Financial, the nation's third largest subprime lender, has revealed it's the focus of a criminal probe about its accounting and securities trading. If its creditors refuse to bend, it could be heading for bankruptcy. And in just a single day this month, its stock lost over *two thirds* of its value.

HSBC, the biggest bank in Europe, just announced a whopping 51% surge in bad loans at its North American unit, and a stunning $10.6 billion loss related to surging delinquencies and mortgage losses.

Goldman Sachs, Morgan Stanley, and other major Wall Street firms could be next to announce write-downs and losses. Many are heavily invested in firms like Fremont and New Century through multi-billion-dollar loans, mortgage investments and credit lines.

New Century alone was responsible for almost $60 billion in new mortgage loans last year. If it goes under, bad mortgages are going to pile up all over Wall Street. So it should come as no surprise if the shares of brokerage firms, ma-

jor banks, and other lenders start taking big hits.

This is the mortgage meltdown we've been warning you about. It's here. And it's now.

The big concern: Until recently, the debt troubles were confined mostly to the subprime sector of the market. Now they have migrated up the food chain — to larger, more diversified mortgage lenders ... even major investment banks.

Meanwhile, it's also spreading to a broader segment of American homeowners. Until recently, for example, surging defaults and foreclosures were mostly among the lowest tier of borrowers. Now, we're seeing the crisis spread to medium-quality loans (called "Alt-A") and home equity loans. Soon, even the traditional mortgage industry could be impacted.

To most of Wall Street, all this has come as a shock. But *Safe Money* subscribers were first warned about this precise crisis 22 months ago. For example ...

In our issue of April 2005, we showed you how money from new-fangled, high-risk mortgages was pouring into the most overvalued real estate assets of all time. We even gave you a list of 25 stocks that "will likely get taken apart as the real estate and mortgage sector unravels." Sixteen of these have fallen. The average decline is 36%. One is off a whopping 90%.

And in June 2005, under the headline "Final Stage of the Real Estate Bubble," we told you, with no punches pulled, that housing was on the verge of a massive decline. Plus, we gave you explicit instructions to dump residential real estate investments.

Since then, existing home sales have dropped 10%. New home sales have plunged 26%. And home prices have fallen more broadly, more sharply, and more consistently than at any other time in the past 30-plus years.

The fall-out: Late last month, the Dow suffered its worst weekly decline in over four years. The Nasdaq lost more in one day than it had at any time in nearly seven years. The dollar fell sharply, especially against the Japanese yen. And a volatility gauge maintained by the Chicago Board Options Exchange exploded by 63% in a single day — *its biggest increase in U.S. market history*.

The next consequences:

1. Fluff investments are likely to sink like an over-baked soufflé. These include stocks that were driven higher mostly by ***hype and cheap money*** — in companies with lousy earnings or shaky business models.

Prime examples: Many REITs and domestic tech stocks.

2. Stocks in the weakest sectors will get slammed further. These include the housing and mortgage companies we've told you to avoid like the plague.

Prime examples: Countrywide Financial, Home Depot, Washington Mutual, Centex, Lennar.

3. At the same time, crisis will breed opportunity. More conservative, higher dividend stocks in stronger sectors are likely to ride out any crisis the best ... and come roaring back the soonest.

Examples: TEPPCO Partners, U.S. Bancorp.

4. Solid companies in high-growth economies will be even more attractive. On a day-to-day basis, their stocks seem to move in tandem with ours. But if you back away from the minor fluctuations and look at the bigger trends, you'll see they consistently outperform their U.S.-based counterparts.

Examples: ABN Amro, New Zealand Telecom.

We give you updated instructions on these in the inside pages. But first ...

Here's Why the Mortgage Industry is Melting Down ...

Countrywide is so big — servicing a massive $1.3 trillion in mortgage loans — that is a good indication of what's happening nationwide. The scoop:

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* In the December quarter, a whopping 19% of the subprime loans it services were at least 30 days behind on their payments.

* Delinquencies on its home equity loans jumped from 1.6% in 2005 to 2.9%.

* Delinquencies on its medium-quality Alt-A mortgages *doubled* — from 1.2% to 2.4%.

Meanwhile, across the entire mortgage industry ...

* Roughly 10.1% of subprime mortgages packaged into bonds are at least 90 days overdue, the worst default rate in at least seven years.

* Specialized indexes that track the performance of derivatives based on loans — such as credit default swaps — are tanking left and right. One plunged 30% in February alone.

* As a result, the cost of insuring $10 million in mortgage bonds surged from just $389,000 to a whopping $1.54 million in a matter of weeks.

Meanwhile, the housing decline is not over. In January, existing home prices slumped more than 3% ... new home sales dropped by more than 20% ... and housing starts plunged by a whopping 38%.

The result is predictable: Unprepared investors are in a state of panic or paralysis. Mortgage bond holders are dumping their high-risk bonds. And lenders, belatedly rushing to close the barn door, are tightening up their mortgage standards.

According to a recent Fed survey, if you compare the lenders that are *loosening* standards with those that are *tightening*, you get a net 16.4% of those that are now tightening. That's a dramatic change from the second quarter of 2006, when more lenders were actually *loosening* their standards. And it's the highest reading since 1991.

Why the Days of Dirt-Cheap Money on Wall Street Are Numbered

Let's say you're a trader at a Wall Street firm like Goldman Sachs. You figure the more money you can borrow ... and the lower the interest rate ... the greater the potential return you can generate. So you naturally seek out the cheapest money you can find.

One of your favorite sources: a Japanese banker offering you his money at dirt-cheap interest rates. So you borrow that money in Japanese yen. You convert those yen into dollars. And then you re-invest the money in the highest yielding investments you can find, such as securities based on high-risk U.S. mortgages.

Everyone's happy. You get a cheap play. The Japanese banker gets more interest than he could get in Japan. And the American borrower gets a cheaper loan than he could have gotten otherwise.

Esoteric? No. This transaction, known as the "yen carry" trade, has had a big impact on U.S. markets ...

* *It helped inflate the U.S. housing bubble.* Lenders were flooded with so much money, they willingly made mortgages to any and all comers. Bad credit? Little or no money for a down payment? Ridiculously high debt-to-income ratios? No proof of income or assets? No problem! You could still get a mortgage.

* *It has helped drive U.S. commercial real estate prices to ridiculous levels.* Buyers have been snapping up office buildings, shopping malls, and other properties with reckless abandon. And they've paid such exorbitant prices that their rates of return are dwindling to practically nothing.

* *It has kept a lid on U.S. bond yields.* The Federal Reserve Board hiked short-term interest rates 17 straight times between mid-2004 and mid-2006. But long bond yields barely budged. Reason: Lots of cheap foreign money flooding into the U.S. and chasing virtually anything with a yield.

* *It drove fear out of the U.S. credit markets.* When lenders are duly afraid of losses and wary of risk, they demand that higher risk borrowers (like smaller, shakier companies) pay a heck of a lot more interest than larger, sturdier borrowers (such as blue chip companies or the U.S. Treasury Department). But in recent years, with money pouring in from overseas, the premium demanded from high-risk borrowers dwindled to practically nothing.

In recent weeks, though, two things have changed: For the first time in nearly seven years, the Bank of Japan has started raising its rates. Plus, the Japanese yen has been soaring, making it even more expensive to borrow Japanese money. End result: The days of cheap money from Japan could be ending. If so, it could be the nail in the coffin for subprime mortgages,

(continued on page 7)

Mr. CONSERVATIVE

A Portfolio For The More Conservative Investor

Why high-yield bonds just aren't worth chasing ...

Recent headlines took Wall Street by surprise: "Gauge of Investor Concern Surges by Most Ever" ... "Corporate Bond Risk Increases Most in 18 Months" ... and more. But to us, it is merely the first sting of a market that's finally rediscovering a four-letter word: R-I-S-K.

And for you, it should be a reminder that you're on the right track holding the highest quality investment in the world today:

* Treasury bills that you can buy directly from the U.S. Treasury Dept. For more info, go to www.savingsbonds.gov. Select "Individual/Personal." Then, in the middle left of your screen, click on "Treasury Bills."

* Exchange Traded Funds that invest in short-term Treasuries like the iShares Lehman 1-3 Year Treasury Bond Fund (SHY). Buy it through your broker like any other ETF or stock.

* Money funds dedicated to short-term Treasuries. Two of our favorites: Capital Preservation Fund (www.americancentury.com, 800-345-2021) and the Weiss Treasury Only Money Market Fund (www.weissfund.com, 800-430-9617).

Are we permanently opposed to high-yielding bonds? No, provided the borrowers are improving their finances and you're getting *paid* for the extra risk. But with the rarest of exceptions, that simply has *not* been the case. As we detail in our main article, the finances of most high-risk borrowers are getting worse. And to add insult to injury, the premium they pay over low-risk alternatives is a pittance.

Example: Corporate borrowers rated a low double-B or less pay as little as 2.5 percentage points more than the U.S. Treasury Department. That's within just a *hair of the all-time low* set in 1997.

Bottom line: If you want higher yields, go with our other, income-generating recommendations ...

Portfolio Update

Telecom Corp. of New Zealand (NZT). You should have just added shares of this New Zealand telecommunications provider. The stock features a nice indicated dividend yield of almost 7% at recent prices. And since it's in a stable business, it should hold up fairly well even in times of market corrections. Sit tight. Or if you don't yet own it, buy 100 shares at the market (assuming a model portfolio of about $100k).

Ditto for **Chunghwa Telecom Co. (CHT)**, a Taiwan telecommunications company with a dividend yield near 6.6%. If you own it, hold. If not, buy 100 shares at the market.

Prudent Global Income Fund (PSAFX) holds short-term, government debt issued by countries like Switzerland, Canada, and Singapore. When their currencies rise, this fund tends to rise in tandem. If it's in your portfolio, keep it. Otherwise, buy 400 shares at the market.

U.S. Global Investors Global Resources Fund (PSPFX) has delivered an average total return of more than 28% over the past three years; 37% over the past five. It invests in a diversified portfolio of companies that mine, or drill for, oil, gold, copper, and other metals.

We recommend you take the money raised from selling UNWPX (see page 6) and use it to boost your exposure to PSPFX. Specifically, buy 200 shares at the market. That will bring your total holdings to 400 shares. If you don't own these positions for whatever reason, get on board by purchasing 400 shares of PSPFX at the market.

U.S. Bancorp (USB) is a diversified, conservative bank that we deliberately picked because, unlike many others, it is *not* joined at the hip to the mortgage industry, and it provides a respectable dividend yield of more than 4.5%. Hold. Or if you don't own it, buy 100 shares at the market.

TEPPCO Partners (TPP) just sold a 50% interest in Mont Belvieu Storage Partners and some other assets, giving it $168 million to spend on its Jonah Gas Gathering System and other growth initiatives. Hold. Or, if you don't own it, buy 50 shares at the market.

mr. speculator

Inverse Dow 30 ETF and Inverse Real Estate Fund Surge!

How do you handle a turbulent market? Selectively buy the sectors or countries that offer the strongest fundamentals and best values. At the same time, use inverse index funds or inverse ETFs to protect yourself — and even profit from — market declines.

Right now, for example, you should already have two inverse positions — the **Short Dow30 ProShares Exchange Traded Fund (DOG)**, designed to go up when the Dow Industrials go down … and the **Short Real Estate ProFund (SRPIX)** designed to go up when the Dow U.S. Real Estate Index goes down.

These are still off from when we bought them. But from its February low, SRPIX has shot up almost 11%; while DOG gained about $3.00 in the same period. If you own them, hold. If not, buy $15,000 worth of SRPIX at the market and buy 50 shares of DOG at the market.

Another vehicle to consider: **UltraShort Financials ProShares (SKF)**, designed to rise 2% for every 1% drop in the Dow Jones U.S. Financials Index — a must-own protection if you've got a lot of banks in your portfolio with a big exposure to the mortgage meltdown. (We don't have that exposure in *Safe Money's* model portfolios. So we'll wait before recommending it here.)

Portfolio Update

You should have taken a 24.9% gain on **Huaneng Power International (HNP)** and you should have been stopped out of **China Unicom (CHU)** with a gain of 10.6%.

Plus, we recommended two new positions last month — **Vastned Offices/Industrial NV (VWN on the Euronext exchange)** as a "bonus" pick for subscribers able to trade overseas and **ABN Amro Holdings (ABN)** as a recommendation you can buy right here in the U.S.

ABN is off to a positive start — up 10.4% despite the market correction. One reason: Hedge fund TCI Fund Management went public with a complaint that ABN is significantly undervalued. The fund owns more than 1% of ABN, and its efforts could lead to an ABN takeover or some other plan that could drive its share prices higher. Hold. Or, if you're not on board, buy 50 shares at the market.

Vastned hasn't moved much since you bought its shares. But we're expecting nice capital gains and nice dividends over time. If you own it, hold. If not, and you have a broker that trades on the Euronext exchange, you can buy 50 shares at the market.

Campbell Soup (CPB): If you haven't done so already based on our Flash Alert, raise your stop on this position to $35.40 from $34.00. If you don't own it, buy 100 shares at the market, and then place the stop order.

iShares MSCI Hong Kong Index Fund (EWH): Hold. Or if you don't own it, buy 100 shares at the market.

Raytheon (RTN): Moody's Investors Service just raised its credit rating on this defense contractor. The main reason: Raytheon is using some of the $3.3 billion in proceeds from the sale of its business jet unit to cut debt. Hold. Or, if you don't have it, buy 50 shares at the market.

United Industrial (UIC): The company's AAI Services unit just received a $14.9 million contract, calling for the delivery of another maintenance training system to the Air Force in October 2010. The stock is up nicely from its November low. Hold. Or if you don't yet own it, buy 50 shares at market.

January 2008 Hess Corp. LEAPS call (WHS AA) and **January 2008 Home Depot LEAPS put options (WHD MG):** Hess has rallied off its Fall low thanks to a rebound in oil prices (good news for your calls). And, Home Depot is rolling over in response to the company's forecast that profit will fall in 2007 (good news for your puts). Hold both. If you're not yet on board with the Home Depot LEAPS, **buy 3 contracts, paying no more than $3 for each**.

"Gold Disappointment" Talk on Wall Street Is Highly Misleading

When the stock market fell in late February, gold dropped more than $40 in a matter of days, and mining shares slumped in tandem. So some Wall Street pundits jumped on the opportunity to deride the yellow metal on CNBC and in print.

"Gold was supposed to go up when the stock market went down," they snickered.

"Gold was supposed to be the perfect crisis hedge," they said with a chuckle. "But look what happened instead! Gold was a disappointment. It has lost its glitter as a safe haven."

Our retort: This kind of gold bashing is misleading.

Gold is — and has always been — a safe haven for investors fleeing a wide variety of crises — inflationary surges, dollar plunges and the threat of geopolitical turmoil.

But gold was never intended to be a hedge against any and all stock market declines.

For that, we have always recommended an entirely separate set of investments — such as reverse ETFs or reverse index mutual funds — that are specifically *designed* to hedge against declining stocks. (See Page 5 and the enclosed supplement for details.)

Meanwhile, the most powerful fundamental forces driving gold are still in high gear:

* The inflation numbers are worsening ...

* The U.S. dollar is continuing to slide ...

* Federal Reserve Chairman Bernanke is continuing to pump up the nation's money supply, and ...

* If the mortgage meltdown worsens, he's likely to pump in even more.

Our forecast: Continue to allow for some more gold weakness in the short term. But if you get it, use it as another buying opportunity.

Portfolio Update

While we wait for our next buy signal, we recommend you hold nearly all your positions. Plus, here are some housekeeping adjustments we recommend:

First, take more profits in your U.S. Global Investors World Precious Minerals Fund (UNWPX). You should have banked 88% on the first half of this holding in August 2006. Now, assuming you bought on our original recommendation, you can sell the balance for *another* gain of close to 80%.

Next, take most of the proceeds and transfer them to **U.S. Global Investors Global Resources Fund (PSPFX)** (See page 4 for specifics).

Second, sell your shares of Coeur d'Alene Mines (CDE). We hoped investor concerns over its Bolivian exposure would dwindle. But they continue to act as a drag on this stock's performance. Long term, it's still a good company. But we'd rather redeploy this money elsewhere, as soon as we get our next buy signals. Sell your shares at $4 or better.

Third, hold steadfastly to the following:

■ **streetTRACKS Gold Trust (GLD)** gives you an easy, convenient way to buy and hold gold bullion. If you own it, hold. If not, buy 50 shares at the market.

■ **Agnico-Eagle Mines (AEM)** reported that fourth quarter profit more than tripled, thanks to surging gold and zinc prices. Net income was $41.9 million, or 34 cents per share, up from $13 cents per share a year earlier. Sales surged 93%.

Meanwhile, the company is going to buy the remaining 97.4% of Cumberland Resources that it doesn't already own for $581 million, boosting its reserves by 28% to 13.3 million ounces.

Hold! Or, if you don't have it yet, buy 100 shares at the market.

■ **Kinross Gold (KGC)** finished acquiring Bema Gold for $3.7 billion in late February, boosting Kinross' reserves in Russia and Chile at a time when the company's results are already improving.

Indeed, Kinross just reported $41 million in profit in the fourth quarter, a dramatic swing from the year-earlier loss of $154.3 million. Hold. Or, if you don't own it, buy 150 shares at the market.

Safe Money Model Portfolio

	Ticker	Reco Date	Entry Price	Quantity	Stop	Dividend Yield (%)	Current Reco	(What to do if you don't own it.)
Mr. Conservative: Approx. 4/5 of Model $100,000 Portfolio								
Energy Investments								
US Global Resource Fund	PSPFX	12/05/05	$15.43	400	N/A	6.29	**Buy 200 shares at market**	*(Buy 400 shares at market)*
Gold & Silver Investments								
Agnico-Eagle Mines Ltd	AEM	07/10/06	$33.50	100	$33.00	0.32	**Hold**	*(Buy 100 shares at market)*
Coeur d'Alene Mines Corp	CDE	02/07/06	$5.00	200	N/A	N/A	**Sell at $4 or better**	
Gold Bullion	N/A	11/08/99	$289.75	4	N/A	N/A	**Hold**	
Kinross Gold	KGC	12/11/06	$12.42	150	$10.50	N/A	**Hold**	*(Buy 150 shares at market)*
streetTRACKS Gold Shares	GLD	02/24/05	$43.33	25	$55.00	N/A	**Hold**	*(Buy 50 shares at market)*
streetTRACKS Gold Shares	GLD	11/21/05	$48.99	25	$55.00	N/A	**Hold**	
USGI World Precious Minerals Fund	UNWPX	04/05/04	$17.11	150	N/A	5.93	**Sell at market**	
Other Funds & Stocks								
Chunghwa Telecom Co	CHT	01/08/07	$19.71	100	$16.30	6.59	**Hold**	*(Buy 100 shares at market)*
iShares Lehman 1-3 Yr Treas Bond	SHY	01/08/07	$80.02	50	N/A	4.17	**Hold**	*(Buy 50 shares at market)*
Prudent Global Income Fund	PSAFX	01/09/06	$11.87	200	N/A	N/A	**Hold**	*(Buy 400 shares at market)*
Prudent Global Income Fund	PSAFX	12/11/06	$12.91	200	N/A	N/A	**Hold**	
Telecom Corp of New Zealand	NZT	02/05/07	$26.59	100	$21.00	8.37	**Hold**	*(Buy 100 shares at market)*
TEPPCO Partners, LP	TPP	12/11/06	$40.39	50	$37.90	6.28	**Hold**	*(Buy 50 units at market)*
U.S. Bancorp	USB	010/09/06	$33.73	100	$32.00	3.94	**Hold**	*(Buy 100 shares at market)*
Cash and Equivalents 1/3 of Conservative Portfolio								
3 Month T-Bill	N/A	12/31/00	N/A	N/A	N/A	N/A	**Hold**	
Mr. Speculator: Approx. 1/5 of Model $100,000 Portfolio								
Reverse-Index Funds								
Profunds Short Real Estate	SRPIX	06/14/06	$28.28	530	N/A	3.90	**Hold**	*(Buy $15,000 in shares at market)*
Short Dow30 ProShares	DOG	08/07/06	$68.87	50	$55.50	1.45	**Hold**	*(Buy 50 shares at market)*
Positions								
ABN Amro Holdings	ABN	02/05/07	$32.02	50	$28.50	4.19	**Hold**	*(Buy 50 shares at market)*
Campbell Soup Co	CPB	06/05/06	$36.04	100	$35.40	1.91	**Hold**	*(Buy 100 shares at market)*
General Mills Inc	GIS	01/09/06	$49.74	25	$50.50	2.52	**Hold**	*(Buy 25 shares at market)*
Hess Corp LEAPS Jan 08 58.38 Calls	WHS AA	07/10/06	$8.20	1	N/A	N/A	**Hold**	
Home Depot LEAPS Jan 08 35 Puts	WHD MG	07/10/06	$3.60	3	N/A	N/A	**Hold**	*(Buy 3 contracts at $3 or better)*
iShares MSCI Hong Kong Index Fund	EWH	01/08/07	$16.27	100	$14.50	2.02	**Hold**	*(Buy 100 shares at market)*
Raytheon Co	RTN	09/05/06	$47.85	50	$48.00	1.81	**Hold**	*(Buy 50 shares at market)*
United Industrial Corp	UIC	09/05/06	$55.26	50	$39.00	0.75	**Hold**	*(Buy 50 shares at market)*
Vastned Offices	VWN NA	02/05/07	$30.50	50	N/A	7.51	**Hold**	*(Buy 50 shares at market)*

The table includes all open positions recommended in the monthly *Safe Money* newsletter or flash alerts. The model portfolio assumes a total investment of $100,000. If your portfolio is larger or smaller, you should adjust the specific recommendations accordingly. For any remaining funds not invested in our recommended stocks and mutual funds, we recommend a Treasury-only money market fund for safety and liquidity.

New Subscribers: Follow the recommendations in parentheses and any new recommendations.

*Newly raised stop-loss.

Cover Story

(continued from page 3)

the end of the commercial real estate bubble, and a big threat to Wall Street's big pile-up of high-risk derivatives and high-risk debts.

Your Steps ...

Step 1. Stay away from the sectors we've identified as the weakest — subprime lending, housing, and construction. We told you to dump the dogs in these sectors long ago.

If you acted on our recommendations, you should have saved yourself a lot of grief and, possibly, a boatload of money. If you didn't, it's not too late to cut your losses. Plus, we also recommend investments that are

designed to *profit* from the decline. (See page 5.)

Step 2. Go for the stocks with solid fundamentals and good dividends. There's a reason we've recommend only a handful of domestic stocks like **General Mills (GIS)** and **Campbell Soup (CPB)** ... plus foreign stocks like **ABN Amro (ABN)**, **Chunghwa Telecom (CHT)**, and **Telecom Corp. of New Zealand (NZT)**. There are few that combine solid dividend yields, stable businesses, and strengths that can help protect you from turbulent times.

Step 3. Diversify by investing in countries where fundamentals remain strong. Taiwan export orders surged 17.3% year-over-year in January, above the 13.2% forecast. Hong Kong has upped its growth forecasts to as high as 6.5% thanks to rising exports, tax cut proposals, and more. China continues to expect double-digit gains this year in consumption, fixed-asset investment, and exports.

Step 4. Raise stops to help lock in more profits. If you raised your stops based on our February 23 Flash Alert, your move was well-timed. If not, do so now. (See our new stop levels in the table on page 7.)

Step 5. Hedge. Make sure you own the hedges we've been recommending. Plus, if you've got other portfolios that are not modeled after our *Safe Money* portfolios, seriously consider "How To Carefully Protect Your Portfolio in Down Markets" — an extra supplement I'm enclosing as my way of saying "thank-you" for your continuing loyalty.

PROFESSOR INVESTOR
Special Questions From Our Readers

Q. The day after the mini crash last month, there were a lot of seemingly strong, calm voices on Wall Street telling us to "just relax." What do you think about that?

A. We firmly disagree with that approach. If you're not already in synch with our *Safe Money* philosophy, this is your signal to get started. That means reducing your risk, raising cash, hedging, and diversifying beyond U.S. markets.

Q. I understand why U.S. stocks weakened last month. But why did gold take a big hit?

A. Mainly because it had just enjoyed a sharp run-up to $690 per ounce. Meanwhile, oil has been steadily rising. And if you look at both gold *and* oil over the last year or two, you'll see no change in their long march to higher levels.

Q. Among all the reasons you've given to invest in the strongest foreign countries, the one that's got me most convinced is the falling dollar. Should I seek to avoid dollar transactions entirely?

A. No. Our model portfolio is designed to give you what we feel is the best balance between (a) U.S. investments that are solid and (b) investments that protect you — or even help you profit — from a dollar decline. Examples: Foreign bond funds, gold shares, foreign stocks, and more.

Q. Where can I get the numbers on U.S. money supply?

A. You can find the Fed's weekly data on M1 and M2 on the Web at www.federalreserve.gov/releases/h6/.

Unfortunately, the Fed decided to stop publishing M3 in March 2006. But Shadow Government Statistics tracks an estimate of M3 at www.shadowstats.com/cgi-bin/sgs/data.

Q. I bought Vastned on the pink sheets under the ticker symbol VSNDF. Is that the correct stock?

A. There are two Vastned companies — one focused on office and industrial property, and one focused on retail. VSNDF is the RETAIL property owner.

We recommended Vastned Offices/Industrial NV (VWN NA on the Euronext exchange). But we do not recommend buying this bonus pick on the pink sheets — only via brokers that know how to trade on overseas markets directly such as Euro Pacific. If you're not comfortable with that, stick with our regular recommendations.

Q. Chinese stocks got hit hard recently. Does that change your take on the country's prospects?

A. No. China's economy continues to grow at a rapid rate. And China's 1.3 billion people are investing and consuming like never before.

MARTIN WEISS'
Safe Money
REPORT

March 2007

How to Carefully Protect Your Portfolio in Down Markets

by Martin D. Weiss, Ph.D.

Safe Money subscribers sometimes ask: "Why do you recommend investments like Short Dow30 ProShares Exchange Traded Fund (symbol DOG)?"

The answer: When the Dow declines, it helps you protect your portfolio.

Indeed, this ETF is just one of many new inverse (or reverse) ETFs and mutual funds that are specifically designed to go UP when the market goes down. So in this special report, I will show you how to make better use of these to carefully protect your portfolio in down markets.

If your portfolios currently match our *Safe Money* model portfolios pretty closely, you probably do not need to go beyond what we recommend in our regular issues. But if you have a substantial exposure to other U.S. stocks — especially those that are among the most vulnerable to the real estate troubles we've been warning you about — you may want to take some of the additional steps I outline here.

Three Convenient Hedging Instruments

Suppose you're concerned the stocks you own are likely to decline. But, at the same time, suppose you're either unwilling or unable to sell them. What do you do? My recommendation is to allocate a modest percentage of your funds to a hedge — to generate profits that will help offset the losses.

There are three convenient hedging instruments available to you:

Instrument #1. Inverse index mutual funds are designed to go up in value as the index they're tied to goes down.

For example, you can buy a inverse index fund that's tied to the S&P 500 Index: If the S&P 500 goes *down* by 10 percent, the fund is designed to go *up* by 10 percent, and vice-versa.

Or, you can also buy the *double-leverage* variety: if the S&P 500 goes down by 10%, the fund is designed to go up by *20 percent*.

Instrument #2. Inverse index ETFs serve the same function as the inverse index mutual funds. They're designed to go up in value as the index declines. And you have the choice of buying double-leverage ETFs as well.

Plus, the ETFs offer some added advantages: You can invest with very small minimums. You can buy and sell them during the trading day. Since they trade like a stock, you can more easily buy and sell ETFs issued by different firms. And you can do so directly in your own brokerage account, either online or offline.

Instrument #3. Long-term put options (LEAPS) give you more leverage and more choices, allowing you to also hedge against individual stocks. Plus, unlike ordinary options, they don't expire for up to two years or more, giving you the time you may need to take advantage of longer term trends.

All three instruments involve risk of loss, especially if stocks or indexes are generally moving higher. So they're not appropriate for your core, long-term wealth building strategy.

But even in a bull market, you can use them to protect your wealth. In a bear market, they give you the potential to generate very substantial profits. And no matter what happens, when you purchase mutual funds, ETFs or LEAPS, you can never lose more than you invest (plus any commissions you pay your broker).

I will discuss LEAPS in a future report. For now, here are some steps to consider with inverse index funds or inverse ETFs.

Step 1. Evaluate your stock portfolio with a series of questions:

Do you have a substantial amount in tech stocks? If so, there are inverse index mutual funds and ETFs that go up when the tech-heavy Nasdaq goes down.

Do you have a large allocation to Dow stocks? If so, then consider the inverse index mutual funds and ETFs tied to the Dow.

What about specific sectors, like commercial real estate? What's your exposure there? Right now, there are handy instruments for hedging against several sectors. And soon, there will be instruments available to hedge against many more sectors.

Step 2. Determine how much you want to set aside for your hedges. To help you think that through, let me first show you what the different possibilities are, and then tell you which ones I prefer.

Possibility A. Let's say you have a $100,000 stock portfolio and you want to protect the entire amount using single-leverage ETFs. That could be very costly. For every dollar in your portfolio, you'd have to invest another dollar in the inverse ETFs. That would mean coming up with *another* $100,000 from some source to throw into the game.

If you were at Las Vegas, that would be tantamount to betting half your money on the red and half your money on the black. You figure you can't lose. But the flip side of the coin is that you can't win either. And when you consider all the costs and commissions, you wind up losing after all.

Possibility B. Instead of full protection, why not settle for half protection? In other words, for every $1 of current value in your stock portfolio, you'd put up only 50 cents of your money into the inverse index ETFs. Assuming a stock portfolio worth $100,000, that would be $50,000 for the hedge.

Possibility C. Use a inverse ETF that gives you double leverage. Now, to protect half of your $100,000 portfolio, all you'd need to invest is $25,000. Assuming your portfolio falls 10% in value and you do a good job matching

your hedges to the stocks you own, here's what you'd have:

Hedging only HALF Your Portfolio with Double Leverage		
	Your Stock Portfolio	Your Hedge Portfolio
Before 10% Market Decline:	$100,000	$25,000
After 10% Market Decline:	$90,000	$30,000
Loss/Gain	-$10,000	$5,000

End result: A $10,000 loss in your stock portfolio, a $5,000 gain in your hedge portfolio, and a $5,000 loss overall. That cuts your risk of loss in half. Not bad. But you ask: Can't we do better than that? The answer: Absolutely, as you'll see in the following steps ...

SELLING 1/3 of Your Stocks: THEN Hedging with Double Leverage!		
	Your Stock PortfolioYour	Hedge Portfolio
Before 10% Market Decline:	$66,667	$33,333
After 10% Market Decline:	$60,000	$40,000
Loss/Gain	-$6,667	$6,667

Step 3. Rather than invest additional funds in your hedge program, raise those funds by liquidating one third of your stocks. Then, here's what you should wind up with:

You'll have $66,667 left in your portfolio, and $33,333 available to invest in the inverse index ETF with double leverage.

If the market falls 10%, you'll have about a $6,667 loss in your portfolio and approximately a $6,667 gain in your hedge. End result: No loss (except for commissions and costs).

This simple step brings you two advantages: First, you won't have to dig into your cash assets to fund your hedge portfolio. And second, you'll get *close* to full protection for the balance of your stock portfolio.

Again, the reason I stress the word "close" is because you'll still have to pay commissions and some costs. Plus, the double-leverage inverse ETFs do not always deliver the *full* double leverage they're designed to provide.

You could stop there and you'd have achieved your goal of risk protection. But if you want to apply some additional intelligence (with some additional risk), you can do even better by following a couple of advanced steps ...

Step 4 (advanced). Instead of liquidating one third of your stocks randomly, strictly get rid of the ones that are in the riskiest sectors, while holding on to those that are the strongest sectors. In our regular *Safe Money Report*, we'll tell you which ones we believe they are. But let's assume we're only half right and we get the following results:

Overall market: Down 10%
Weakest sectors: Down 20%
Strongest sectors: Down 5%

In this scenario, we're half right in the sense that the strongest sectors outperform. But we're also half wrong because, instead of rising as we expected, they still go down, although not as sharply. I think that's a reasonable expectation. But even in this situation, you wind up a winner:

SELECTIVELY Selling 1/3 Your Stocks: Then Hedging!		
	Your Stock Portfolio	Your Hedge Portfolio
Before 10% Market Decline:	$66,667	$33,333
After 10% Market Decline:	$63,333	$40,000
Loss/Gain	-$3,333	$6,667

Since your remaining stocks are in the strongest sectors, your loss is reduced from 10% to 5%, or $3,333. Meanwhile, you're still gaining 10% on your hedges, or $6,667. End result: Despite the market's overall decline of 10%, you actually come out ahead.

Step 5 (more advanced). Assume the same scenario as the previous example. And take the same steps. But, in addition, instead of hedging with a inverse index ETF that matches the broad market, hedge with sectors that we believe to be the weakest. Again, there's no guarantee that we're going to be right. But, assuming we are, here's how it would turn out: (See table on next page.)

You'd still have a $3,333 loss in your stock portfolio. But, in your hedge portfolio, with the

SELECTIVELY Selling 1/3 Your Stocks AND Hedging SELECTIVELY!		
	Your Stock Portfolio	**Your Hedge Portfolio**
Before 10% Market Decline:	$66,667	$33,333
After 10% Market Decline:	$63,333	$46,667
Loss/Gain	-$3,333	$13,333

bad sectors falling 20% and your double-leveraged ETFs giving you a 40% gain, you'd have a gain of $13,333.

Your net gain overall: $10,000.

You've just turned what could have been a $10,000 loss in your portfolio into a $10,000 gain instead. That's what I call *turning the tables on the market.*

Most of The Instruments You'll Need Are Already Available

Fortunately, all of the ETFs you'll need for steps 1 through 4 are already available for purchase. (See listing on the table below).

The only ones that may not be unavailable yet are those needed for Advanced Step #5 — ETFs that are designed to go up in value as individual sectors decline. But they're already in the works and should be ready for purchase soon.

In the meantime, go forward with steps 1 through 3 to fully protect your portfolio, and, if you wish to take on some additional risk, as far as step #4.

In your regular monthly issues of *Safe Money Report*, or in our e-mail alerts, we'll let you know as soon as the inverse sector ETFs are available, so you can add that last layer of protection and profit potential.

Target Index	Mutual Fund or ETF	Symbol	Leverage
Dow Industrials	Rydex Inverse Dynamic Dow	RYCWX	Double
	ProFunds UltraShort Dow 30 Inv	UWPIX	Double
	Short Dow30 ProShares	DOG	Single
	UltraShort Dow30 ProShares	DXD	Double
Nasdaq 100	ProFunds Short OTC Inv	SOPIX	Single
	ProFunds UltraShort OTC Inv	USPIX	Double
	Rydex Inverse OTC (Arktos)	RYAIX	Single
	Rydex Inverse Dynamic OTC	RYVNX	Double
	Short QQQ ProShares	PSQ	Single
	UltraShort QQQ ProShares	QID	Double
Russell 2000	ProFunds Short Small-Cap Inv	SHPIX	Single
	ProFunds Ultra Short Small-Cap Inv	UCPIX	Double
	Rydex Inverse Russell 2000	RYSHX	Single
	Rydex Inverse Dynamic Russell 2000	RYIRX	Double
S&P 500	ProFunds Bear Inv	BRPIX	Single
	ProFunds UltraBear Inv	URPIX	Double
	Rydex Inverse S&P 500 (Ursa)	RYURX	Single
	Rydex Inverse Dynamic S&P 500	RYTPX	Double
	Short S&P 500 ProShares	SH	Single
	UltraShort S&P 500	SDS	Double
S&P Midcap 400	ProFunds Ultrashort Mid-Cap Inv	UIPIX	Double
	Rydex Inverse Mid Cap	RYMHX	Single
	Short MidCap400 ProShares	MYY	Single
	UltraShort MidCap400 ProShares	MZZ	Double