

THE BULL HUNTER

Tracking Today's Hottest Investments

DAN DENNING



WILEY

John Wiley & Sons, Inc.

THE BULL HUNTER

THE BULL HUNTER

Tracking Today's Hottest Investments

DAN DENNING



WILEY

John Wiley & Sons, Inc.

Copyright © 2005 by Dan Denning. All rights reserved

Published by John Wiley & Sons, Inc., Hoboken, New Jersey

Published simultaneously in Canada

No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning, or otherwise, except as permitted under Section 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, 222 Rosewood Drive, Danvers, MA 01923, 978-750-8400, fax 978-646-8600, or on the web at www.copyright.com. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc., 111 River Street, Hoboken, NJ 07030, 201-748-6011, fax 201-748-6008, or online at <http://wiley.com/go/permissions>.

Limit of Liability/Disclaimer of Warranty: While the publisher and the author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. No warranty may be created or extended by sales representatives or written sales materials. The advice and strategies contained herein may not be suitable for your situation. You should consult with a professional where appropriate. Neither the publisher nor the author shall be liable for any loss of profit or any other commercial damages, including but not limited to special, incidental, consequential, or other damages.

For general information about our other products and services, please contact our Customer Care Department within the United States at 800-762-2974, outside the United States at 317-572-3993 or fax 317-572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books. For more information about Wiley products, visit our web site at www.wiley.com.

Library of Congress Cataloging-in-Publication Data:

Denning, Dan.

The bull hunter : tracking today's hottest investments / Dan Denning.

p. cm.

ISBN-13 978-0-471-71983-0 (cloth)

ISBN-10 0-471-71983-8 (cloth)

1. Capital investments. 2. Bull markets. I. Title.

HG4028.C4D45 2005

332'.0415—dc22 2005003086

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

CONTENTS

<i>Foreword</i>	vii
<i>Acknowledgments</i>	ix
INTRODUCTION	1
CHAPTER 1: DEBT, DEFICITS, AND THE DOLLAR: AMERICA'S KILLER Ds AND WHY THE OLD INVESTMENT STRATEGIES DON'T WORK	19
CHAPTER 2: A BULL HUNTER'S SOLUTION TO THE DOLLAR CRISIS	39
CHAPTER 3: ETF STRATEGIES IN ACTION	63
CHAPTER 4: THINKING THE UNTHINKABLE: ETF OPTIONS STRATEGIES FOR A DANGEROUS WORLD	81
CHAPTER 5: THE MONEY MIGRATION	109
CHAPTER 6: THE DRAGON IN THE PIN-STRIPED SUIT	131

Contents

CHAPTER 7: BOMBAY DREAMS AND ECONOMIC REALITY IN INDIA	151
CHAPTER 8: INSIDE THE DECISION CYCLE: THREE FINAL STRATEGIES FOR INVESTING IN TOMORROW'S STOCK MARKET	173
CHAPTER 9: WILDNESS LIES IN WAIT	201
<i>Notes</i>	215
<i>Index</i>	219

FOREWORD

The world is in the process of shifting from one in which the United States is the primary engine of international growth to one in which there are multiple engines. This process will not be comfortable for investors and retirees who expect the investment prospects of tomorrow to be like the opportunities of the past decades.

The United States is in the midst of a long-term secular bear cycle. Given the high valuations of the broad stock market, stock market returns are likely to be modest at best in the next 10 years. U.S. bond investors are faced with low interest rates and the serious potential for rising rates, which is not a good environment for bonds.

But that does not mean investors need despair. As the saying goes, there is always a bull market somewhere. There are opportunities awaiting the investor who is willing to do a little extra homework. In *The Bull Hunter*, we get to peek over Dan Denning's shoulder and look at his homework notes, so to speak, as he travels and searches the world looking for opportunity.

While it may not be a smooth ride, the long-term trends that are now in play are setting up opportunities every bit as big as the U.S. stock and bond market in 1982.

Less than 20 years ago, China and India were mired in socialist governments and devastating poverty. Their entrepreneurs were not welcome in the halls of government. That has now changed. The desire of billions of Chinese and Indians to achieve middle-class status is one of the most compelling stories in recent history and will be one of the greatest potential builders of wealth of the new millennium. As an example, we are told that only two decades ago there were less than 60 cars in private hands in all of China. Now they produce that many every four minutes.

They will need commodities like iron, cement, nickel, aluminum, and copper, to list a few among a host of metals required as they build out their cities and homes. Where will an energy-hungry world find the power to enable such a fierce drive to improve their lot in life? Just the need for energy and raw materials to supply them is enough to create whole new bull markets.

And when you add together the populations of the nations surrounding China and India, you find another billion people with the same goals of improving not only their own lives but those of their children!

But the story is not just one of an improving environment for commodities and energy. There are far more bull markets that will be born in the coming years both at home and abroad, as entrepreneurs throughout the world will find new products and ways to serve their customers.

There are intriguing new investment vehicles like the exchange-traded funds (ETFs) and other new funds, which Dan talks about, that allow us to invest locally and safely while giving us an opportunity to be part of the global growth story.

These new bull markets are an opportunity for us to participate in this powerful new wave of free markets and capitalism. In a world where information is at our fingertips, we should not limit ourselves to yesterday's markets and our own backyard. There is now an entire world we can search for value, seeking out opportunities to improve our own portfolios and net worth. *The Bull Hunter* is a good start.

So good luck and good hunting!

John Mauldin

ACKNOWLEDGMENTS

In his 1947 essay, “Why I Write,” George Orwell said: “It is bound to be a failure, every book is a failure, but I know with some clarity what kind of book I wrote.” If I’ve achieved any clarity in this book, I had some help from some very talented and generous people.

First I’d like to thank Bill Bonner for encouraging me to write a book in the first place. Thanks to all the people at Agora who have been an influence on my thinking and investing over the years, including Steve Sjuggerud, Porter Stansberry, Dan Ferris, Alex Green, Chris Dehaemer, Karim Rahemtulla, James Boric, and especially Eric Fry. Another hearty thanks to talented investors and writers John Mauldin, Greg Weldon, Steve Belmont, Michael Checkan, and Bob Meier, Byron King, and Chet Richards.

Thanks, too, to the many people who made my trip to Asia possible and worthwhile, including Jason Kelly in Japan, Pinank Mehta in India, and Kevin Francis in Sydney. Special thanks go to Debra and Mike Yantis in Koh Samui, Thailand, and Dr. Andre Homberg and Verena Homberg in Perth, Australia, all four of whom went out of their way to introduce me to other investors and show me sights I might otherwise have missed.

Acknowledgments

And thanks to the many people who put up with my frequent e-mails, phone calls, and interminable conversations and who helped make this book possible, including Sala Kannan, who set up many of my meetings in India; Greg Grillot, Joe Schriefer, Cheryl Greene, Tom Dyson, Bob Compton, Sandy Franks, Laura Davis, and Michelle Nickels in Baltimore; and Adrian Ashe, Frank Hemsley, Brian Myers, Merryn Somerset Webb, Mike Graham, Nic Laight, and Lord William Rees-Mogg in London.

Thanks to Addison Wiggin, Thom Hickling, Jack Forde, Mike Palmer, and Jack Howley for being good critics and better friends, and to Mike Ward, Wayne Ellis, Michael C. Thomsett, Mark Ford, and Deb England for all their hard work. Thanks to my sister Virginia for making sure I got all my frequent-flyer miles, and thanks to my entire family for their loving support, of both my failures and my occasional successes.

Dan Denning
London, England
2005

THE BULL HUNTER

INTRODUCTION

LIONS, EAGLES, DRAGONS, AND BULL HUNTERS: A VISION TO PROFIT

Capital investment is heavily concentrated in the goods-producing sector. Ruin that sector, and you will infallibly see less and less capital investment in the economy.

—Dr. Kurt Richebächer¹

Trade, of course, predates manufacturing and has always dominated it. But it's pretty pointless if we don't make anything to trade.

—James Dyson²

It does not do to leave a live dragon out of your calculations, if you live near him.

—J.R.R. Tolkien³

Never turn down help, even if it comes from unexpected places in unexpected forms. I learned this two years ago, when I locked myself out of my apartment in Paris on July 14, Bastille Day, wearing nothing but a pair of boxer shorts and a T-shirt.

This was the summer of record heat in France. And so luckily, nobody was wearing much, even by French standards. I didn't look

out of place wearing a green sarong and a pair of white terry cloth bath slippers I borrowed from a petite femme in the apartment below. I legged my way, with an occasional catcall, through the red-light district on Rue St. Denis to my office, sent an e-mail to the landlord, and waited for three hours to get a spare key. I did not keep the sarong.

Even when it's unlooked for, good fortune may be staring you in the face. So when I again locked myself out of my apartment (this time in London, after midnight, on a cold and rainy Wednesday), I was only a little surprised to get lucky again. I found a small hotel room in a place called the County Hall, just beneath the great London Eye. I turned on the TV and came face-to-face with James Dyson.

Dyson is a British vacuum cleaner magnate. He makes things for a living, instead of buying them. It's a habit that's gone out of style in America, where consuming more than you produce is now the norm.

You may recognize Dyson from TV commercials in which he hawks his products. But on this night, he was hawking something entirely different. It was a very specific idea about why the Industrial Revolution happened in England, and how England went on to become the richest, most powerful nation on earth.

Dyson showed that England got rich through what an economist would call capital-intensive investment. You and I would simply call it manufacturing. It's what made England rich. It's what's making China rich today. And Dyson claims it's how the West—or at least some investors—can get rich again. He also claims that

- “Of the world’s 10 largest corporations by revenue, nine make big, heavy things. Like cars or ships’ turbines or computer hardware or consumer electronics.”
- “These companies rely on their engineering and their technology—not their styling—for their wealth. Only one—Wal-Mart—is a service company.”
- “Look at the most profitable companies, and again, the facts speak for themselves. In the top 10, only three are service companies.”

- “Only one in seven British jobs is in manufacturing, yet they generate nearly two-thirds of exports. Manufacturing creates the wealth and spending power that feed the service industry.”⁴

“It’s obvious,” Dyson concludes, “*the rest of the world relies on manufacturing for its wealth. Why do we think we can be different? If we want to maintain our position alongside other leading nations, we’ve got to join the rest.*” He finished with a history lesson worth keeping in mind:

History repeatedly shows the correlation between a nation’s wealth and its diplomatic and military powers. Before the Industrial Revolution, Britain accounted for just one-fiftieth of the world’s manufacturing output, while China spoke for a third. Fewer than a hundred years later, China had been invaded by a small British army. Its industry was now backward. Britain, with 2% of the world’s population, was making nearly half the world’s goods. And politically, we led the world. So if we want to protect our quality of life and our influence, we must maintain our average wealth—our GDP per capita. The only sure way to do that is to continue to innovate and manufacture. I believe manufacturing is the future, not the past.⁵

FROM ENGLISH TEXTILES TO GLOBAL FORTUNES

Dyson is not the first Englishman to rediscover what made his country great and what is currently enabling China to clobber the rest of the West economically. Knowing I was interested in the history of how the West got rich, a colleague asked me to review a book called *Capital and Innovation*, by Charles Foster (Arley Hall Press, 2004).

The book reached many of the same conclusions as Dyson did about what made England rich. Foster’s book is about the economic development of Cheshire and Lancashire counties from 1500 to 1780, which led to the Industrial Revolution in England. It is really a case study of the world’s first industrial economy and its foremost maritime, trade, and military power. *England leapt ahead of the rest of the world and stayed there for nearly 300 years because Englishmen began*

saving, investing, and trading. They saved money from lands that became profitable farms. They invested in new technologies to make the lands more productive (the steam engine, for example). And they traded their newly manufactured goods with their American cousins.

It's really a simple story of individual actions making a nation rich. A good example is Peter Warburton. In 1575 he inherited his father's estate. The total value of his father's possessions at his death was £773. Peter began purchasing leases to increase his income, rather than only farming the land. By the time he died 51 years later, his inherited possessions were worth £12,613—a 1,500 percent increase.

What's even more important is that more than £9,000 of his personal worth was in gold and silver coins. His leases and tithes brought in £1,146 in income. His cattle stock had grown to 213 head, only four more than his father's 209. But because of rising land and grain values, the cattle had doubled in value. Peter Warburton had turned a farm and his leases into a source of passive income for the accumulation of capital.

He was not alone. Dozens of tenants and families were doing the same thing all across England. These families were also developing important traditions that still serve as the bedrock of a healthy economy. They were saving. They viewed their capital as an asset for the wealth of future generations.

As they accumulated capital, all the benefits of investment began to show up in the northwest. Foster explains that employment in the region expanded. Fathers had money to send their sons to London to become doctors and lawyers. And because families were able to accumulate wealth in a liquid form (cash instead of land), more children inherited money than under the previous regime. This had the effect of capitalizing even more future entrepreneurs.

CAN IT WORK TODAY?

Can this sixteenth-century model of economic success really work today? I'll argue later that it already is working—in China. It is now broken in the United States of America.

Companies like General Motors and Ford—which used to be manufacturing giants—have transformed themselves into hedge funds, making more money on their financing operations than on the manufacture and sale of cars. As a whole, the American economy doesn't invest enough money in building things. Today's America (as I'll show later) invests in less durable types of assets. The respected economist, Dr. Kurt Richebächer, explains. The Austrian school of economics shows that savings and investment, not credit and consumption, are the foundation of growing economies. Dr. Richebächer writes of the overall decline in American investment spending and notes:

No less ominous is the shift in the composition of investment spending between different sectors of the economy. Overall investment in information processing is up 20% since 2000, computers making up 84.3% of that. But investment in industrial equipment is down 12.4%, and transportation investment down even 19.2%. It seems a reasonable assumption that the investment spending on information high-tech is centered in the economy's growth sectors, such as retail trade and finance. Investment in industrial equipment is no higher today than in 1995.

Manifestly, manufacturing is the key trouble spot in the U.S. economy. With a loss of almost 3 million jobs, from 17 million, since 2000, the sector accounts singularly for the overall job disaster. All other major sectors had rising employment. Not surprisingly, manufacturing stands out with the weakest investment spending.⁶

This ailment is not a run-of-the-mill cold. It's chronic. And it has real long-term consequences. The doctor continues:

It should immediately be clear that this extraordinary investment weakness is structural, not cyclical, and just as clear also should be its main cause: grossly overexpanded consumer spending, essentially at the expense of saving, investment, production, and the trade balance.

Changes in business capital investment play a crucial role in the process of economic growth through their specific effects on employment, incomes, and profits. There appears to be a widespread view that higher investment essentially reduces consumption. The fact is, rather,

THE BULL HUNTER

that—through the rising production of capital goods—it increases employment and labor income more rapidly than the outflow of capital goods.

We hasten to add that this was true throughout the more than 100 years of Industrial Revolution. This technology involved huge investments in plant and equipment, of which a large part required prolonged production processes. Companies needed numerous workers to meet the huge demand for those capital goods; and once these were manufactured and installed, other firms hired workers to operate them. This investment-driven economic growth was inherently associated with strong growth of employment and incomes.

Lack of capital investment is America's present key problem. That is one reason. The second one is that the new high-tech, for which corporate managers in America have an absolute preference, has very low labor and capital intensity. Between 2000 and 2003, employment by the manufacturers of computers and electronic products plunged from 1.8 million to 1.3 million.⁷

TOMORROW'S ECONOMY OR YESTERDAY'S MISTAKE?

Even on an empty stomach, Dyson's speech was a revelation. When you add in the thoughts of Charles Foster and Dr. Kurt Richebächer, you begin to get a clearer picture of what leads to economic prosperity. But it's virtually unrecognizable today.

What you hear these days is that we're in a "postindustrial" economy. In this fictional economy, personal wealth is generated through rising asset prices and credit-financed consumption. We feel rich buying things instead of getting rich making them.

Now, I've traveled to quite a few places across the world in the last five years including China, India, Japan, Thailand, France, Germany, Italy, England, Mexico, Canada, Australia, and, of course, America. I can assure you that in nearly all of these places, spending money is not a good way to get rich.

What I've seen in all of these places—and from working in the stock market day after day for the last seven years—is a different picture of how to get wealthy that's emerging. I'll tell you some of what

I've seen and discovered in the following pages. I'll also tell you about some of the risks you face if you live, work, and invest in America.

But the most important thing I can tell you is that all over the world, fortunes are being made in more ways than you or I can imagine. For investors, it's as if you woke up one day and found you had 10 times more investment opportunities the night before. The only catch, as you rub the sleep out of your eyes, is figuring out how to profit.

BULL MARKETS ARE DEAD! LONG LIVE BULL MARKETS

For the past 20 years, most investors have viewed the stock market as a foolproof retirement machine. Find the best stocks early and hold them for a long time and you'll retire *really* rich.

But over the last four years, it's become clear that you can't automatically get wealthy buying stocks . . . if stocks aren't in a perpetual bull market. The retirement machine is sputtering. Maybe it's even broken. What do you do?

I have good news for you. The old way of making money in the stock market doesn't work anymore and it's been replaced by something better. Instead of achieving your goals by "being bullish,"—a strategy that won't work if stocks go sideways for 20 years—you redefine *bull market*.

WHAT'S A BULL AND WHAT'S A BEAR

The traditional definitions of bull and bear signify the direction of market prices. If the Dow goes up, it's bullish and we're in a bull market. If it goes down, it's bearish and we're in a bear market.

This leads to the common, but now faulty, belief that the best way to make money investing is to buy stocks only when they are going up. You *can* make money when stocks go down. Bears do it all the time. But it's considered riskier and, by some bulls, in poor taste to profit from falling prices. It's better to be a small boat, lifted by a rising tide. Right?

Every morning I cross the Thames river by walking south across the Waterloo Bridge to the south bank. The Thames is an estuarial river, which means it's close to the sea and its current is affected by the tides. Some mornings the tide is going out and the river is low. Sometimes the tide is coming in (if I'm late to work) and the river literally flows upstream. Either way, the tide is always coming or going, and the flow of the river is always changing.

The tide is coming and going in the world's investment markets, too—everywhere and all the time. Money moves quickly these days. Global capital flows faster than any river. Capital movements cause prices for stocks, bonds, or commodities to rise rapidly in one place, or fall just as rapidly in another.

For investors, the problem is that the tides of global finance are not as predictable as the tides of the Thames. If every market is a river, there are thousands of rivers. You can make money in any single one of them, and you can do so in any number of ways (as I'll show you later).

The key thing is to realize that you have many choices. The terms *bull* and *bear* are simply not relevant today. Beyond the Dow Jones Industrials, mutual funds, and Vanguard index funds is a whole universe of investment opportunities. Today, you can buy Chinese ball-bearing makers, invest in the best companies in Australia, profit from a booming demand in cemented carbide metal-cutting tools, or even trade options and futures—all from your own home.

Sometimes you'll profit when prices rise, sometimes when they fall. It may be a stock, a bond, a currency, or a commodity. But as you cast your investment glance across the globe, you'll see the world has changed to your advantage. In this book, I'll show you precisely what I've seen and how I think you can turn this change into investment profits. Of course, not everyone is comfortable with the idea that the investment rules have changed. It means changing your perspective. But it takes only a slight change to see what I'm talking about.

For example, it's a common but mistaken belief that the investment terms *bull* and *bear* come from the way that these animals approach their respective foes. A bear moves his paw in a downward motion and a bull thrusts his horns upward. In fact, back in the days when traders hunted animals, so-called bear skin jobbers were fur

traders who sold skins from bears they had not yet caught. Think of this as an early futures contract. You got a fixed price today for a commodity to be delivered at a later date. By doing this you hedge your risk that the future price might be less than today's price. But you also risk getting less for your commodity than it will be worth.

For this reason, the term came to describe anyone who sold short on any stock share or commodity. The use of *bull* as the opposite derives from the old practice of pitting bears and bulls against each other as a form of sport. Incidentally, Paris Garden in Southwark is one of the old places where bull and bear baitings were staged in sixteenth- and seventeenth-century London. It's only five minutes' walk from the office I work at today.

LONDON AND MODERN FINANCE

It's no accident that essential terms like *bull* and *bear* come from capitalism's early growth in London. The English got rich by thinking about making money in new ways. It's a skill that Americans picked up, too. It's also absolutely essential if you want to profit in an increasingly complex and interconnected global economy.

As long ago as 1785, today's version of *bull* and *bear* were defined by Thomas Mortimer in his book, *Every Man His Own Broker*. Mortimer wrote:

[A] man who in March buys in the Alley [reference to the exchange in old London, Exchange Alley] 40,000 pounds [for settlement] in May, and at the same time is not worth ten pounds in the world . . . is a Bull, till such time as he can discharge himself of his heavy burden by selling it to another person . . .”

Even then, the English humor was understated. But Mortimer was not finished. He defines a bear as

. . . a person who has agreed to sell any quantity of the public funds more than he is possessed of, and often without being possessed of any at all, which, nevertheless, he is obliged to deliver against a certain time: before