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Dennis Slothower's STEALTH STOCKS

They don't make headlines, they just make money

August 2005

Inside This Issue

Monthly Portfolio Tracker
Raising cash 5

Stealth Stocks' Watch List
Builders continue banging away 6

Stock of the Month
Farm Machinery Company plows ahead 7

Five Stocks that Could Double in a Year
Biopharmaceutical company in hot sector 8

On A Personal Note
Roller-coaster ride 8

Dear Friend,

What is driving all this bullish sentiment? Is it the end of the tightening phase by the Fed or is something else happening? Some ominous signs are appearing on the horizon. One area I am watching very carefully is the breakdown in the banking sector.This is not a good sign for the market. Even with all this uncertainty, there are still opportunities to consider. I want to share a few of them with you this month.

THE VIEW FROM MY SEAT

Soft landing… Pop goes the bubble… The Fed's dilemma… Geopolitical risks mount…

In my 27-year career in this business, the stock market has had either a bullish or a bearish side, and a good investor is able to make money from both sides.The economy was either expanding or it was contracting, but these economic cycles lasted for many months at a time, even years, in terms of persistence, until the cycle reversed. However, during the last 19 months we have had a far different pattern.Advances and declines have lasted for weeks-not months. In fact, over the last two years, the longest period in which we have seen a higher high and a higher low in succession for the S&P 500 is only two months.

Instead, the pattern has been a series of weekly advances, just enough to get investors hopeful-only to reverse in a series of downward whipsaws. I wish it were different, but that is what we have been dealing with. It is a tough environment, but at least the primary trend is starting to favor the bulls. July has been quite a surprise. Investors are growing more hopeful again, especially since the S&P 500 managed to make a new four-year high.The transitional trading channel now has a bullish bias to it, telling me that perhaps better times are ahead.

What is bothering me the most now and the reason I can't give the all-clear-ahead signal is the reversal in market leadership.The end-of-June leadership was looking pretty poor as the OTC lagged all the indexes, but this has changed recently and rather dramatically, I might add, and the change aids the bullish cause. Leading the charge has been the growth stocks sector. I am somewhat surprised to see the biotechnology sector leading all sectors, including technology.This is a worthy development and could hint at better times to come.

please turn…

I recall that back in 1994 the economy was in a similar situation-as the Fed was also orchestrating a "soft landing." At that time, investors began to perceive that the tightening process might be nearing an end. Also at that time, the biotechnology sector led the market higher. In fact, the biotechnology sector in 1995 more than doubled. In the June newsletter, I recommended ViroPharma Inc. (VPHM) in the "Stocks That Could Double" section. At the time of my recommendation, the stock was trading at $4/share. Now it is trading at $12/share; this illustrates just how strong this sector has been lately. To me, it's a very encouraging feather for the bull's hat.

In light of the Russell 2000 and the S&P 500 making new highs, I continue to ask myself, is the stock market is transitioning into a new bull market phase, similar to what we saw happen in 1994-1995 following that soft landing? Or is this just another intermediate rally, taking prices to the top of the trading channel-only to purge investors again with the next intermediate downleg in a fashion similar to what we've seen happen over and over again in the last 19 months?

At this point, I have to peg this as a toss-up. It appears that the bulls are in control for now. Yet at the same time, the stock market is extremely extended on an intermediate basis and at the top of the trading channel as we head into the month of August. Perhaps the economy is in for a soft landing.

Soft landing

Just what is a soft landing? This happens when the Federal Reserve fights inflation and tries to avoid high interest rates to slow the growth rate but is not so aggressive as to cause a recession. In fact, a few months ago, the International Chamber of Commerce conducted a poll of 1,118 corporate and academic economists in 91 countries to evaluate expectations for the global economy. The results of the poll showed that economists are looking for a slowing in economic activity, known as a "soft landing," rather than any sharp decline in economic activity. The poll showed that economic growth is expected to slow for most of 2005.

The market warmly received the June jobs report of 146,000 new jobs, because it wasn't a robust enough number to justify more aggressive tightening, yet was strong enough to support job creation. Corporate earnings have come in better than expected. Corporate earnings for the second quarter for the S&P 500 were expected to drop to 7% from a 12% growth rate in the first quarter. So far it appears that the growth rate is about 10%, which is encouraging the stock market in July. Yet the Fed is still slowly tightening its monetary policies. The growth in the money supply is still subpar.

All my years of experience have taught me that the stock market is a discounting mechanism, looking outward about three to six months and trying to determine what the likely course of events will be in the future. The Fed has made it quite clear it plans on pushing interest rates to the neutral level, not accommodative or damaging to the economy. Currently that rate is at 4.5%. Investors are coming to believe that the Fed will take rates to this level and then stop there. The way I see it, investors don't believe the Fed wants to

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push rates beyond that level, knowing that would cause a disabling recession that could spiral into a disinflation cycle and prove disastrous.

The last time the Fed tried to orchestrate a soft landing was in 1994. It also proved to be a very difficult year, with the market full of whipsaws, and in the end, the market failed to make any progress. These are very challenging times because it is such a fine balancing act that the Fed is attempting. We are in the middle of an unpredictable war in which terrorists can strike at any time. Imbalances such as soaring oil prices can force the Fed to get more aggressive at slowing the economy. The one monkey wrench that can really mess things up is the growing real estate bubble.

Pop goes the bubble

Alan Greenspan's monetary policies helped create a bubble in the stock market that left disastrous consequences in 2000-2002. In the end, it forced the Fed to bring interest rates to near zero to save the economy from ruin. As a consequence of super low interest rates, real estate values have exploded over the last five years. Even Greenspan admitted in his most recent testimony before Congress that speculative bubbles are being created in some markets.

A hyperinflationary spiral has sent home prices shooting up by 10%–40% annually in recent years—depending on the region of the country—and has artificially pushed the price of millions of homes into the $500,000 to $1 million range or above. Ten states and the District of Columbia have seen prices rise more than 70% over the past five years, and prices have more than doubled in 23 markets in California, Florida, and Massachusetts, according to federal figures. In the same time frame, ordinary consumer prices have risen just 13% and personal income has risen 23%.

I am amazed that more than 1 out of every 10 homes for sale in the United States is priced at $1,000,000 or more. This is a huge problem for young families who can't afford to own a home. Millions of families are spending 35%—50% of their annual income on mortgage or rent payments. What happened to the stock market in 2000 is now happening to real estate, and unless corrective measures are taken, an inevitable collapse might develop that could destroy millions of families financially.

I think it is very telling that the Fed is now warning financial institutions that they "may not be fully recognizing the risk" inherent in aggressive lending secured by rapidly rising home values. Home equity loans and cash-out refinancing deals have been a major engine for consumer spending in an economy characterized by relatively slow job and income growth. I know that the Fed is especially worried about lenders that give out loans that pay no principal-requiring little or no money down. They could easily find themselves "underwater" if home prices decline, meaning borrowers would owe the bank more than the home is worth.

The reality is that so much money being sucked into the real estate market poses a serious threat to our financial system if a disinflationary cycle begins. We are on the cusp of this right now. Inflation is falling, which is amazing considering how high crude oil prices are. If the Fed continues to raise short-term interest rates much more, an inverted yield curve will be produced, which has always been a precursor to a recession. This happens when short-term rates are higher than long-term rates. At present, the yield curve is now flat, which means banks are finding it harder to make a profit. When banks borrow at the short-term spectrum of the yield curve and lend out at the long-term rates, it becomes profitable when short-term rates are lower than long-term rates. The spread between short- and long-term rates has become a lot smaller over the past several months.

I am very closely watching Citigroup and Bank of America, whose stock values are rapidly deteriorating. This is very worrisome to me. The financial stocks are not looking good, and that is always a warning sign of potential danger to the stock market. I just hope the Fed does not lead us into a recession in 2006.

The Fed's dilemma

The stock market appears to believe that the Fed can't afford to contract the economy much longer without serious repercussions. It must expand the economy or risk damaging it. The Fed's primary job is to protect the banking system, which is already extremely vulnerable due to its overexposure in real estate. This looks very much like what we saw back in the early 1980s just before the savings and loan debacle, when real estate became overheated.

Mortgage rates are based on the long bond rates. To cool the real estate market, the Fed must promote higher mortgage rates. To do this, the Fed must promote growth for the economy to drive investors out of

$60+ crude oil could spark rotation out of growth stocks.

bonds–forcing long-term yields higher. Here's the Fed's dilemma: If it promotes growth, what will happen to the demand for energy? A stronger economy would only stimulate a greater demand for energy products, driving crude oil prices higher.

That makes this a very difficult situation, with oil prices at $60 a barrel. If the Fed expands the economy, the demand for oil will only increase at a time when we don't have enough refineries to meet the demand. Senator Orrin Hatch recently talked about our oil refinery problem, saying: "We have lost over 200 refineries [to closure] since 1970 and have not built a new one since then."

It's a tough situation. Each $10-per-barrel increase in crude prices is thought to be the equivalent of a $70 billion tax increase for American consumers. How high can oil prices go before it they break the back of the consumer? Would $100 to fill up your SUV do it? From what I have read, our economy would start to unravel quickly if oil prices reach $75 a barrel. I just don't think the stock market is going to ignore another $10 move in oil prices from this level. The Fed is stuck between a rock and an oil barrel. Is it any wonder that the stock market is so choppy and subject to whipsaws?

Geopolitical risks mount

While I fret about the direction of the stock market, radical Muslims from many nations are pouring into Iraq to help the insurgents try to defeat democracy in Iraq. The insurgents hope to ignite a civil war between the Sunnis and the Shias. In fact, some argue that a civil war has already begun. "What is truly happening, and what shall happen, is clear: a war against the Shias," Sheikh Jalal al-Din al-Saghir, a prominent Shia cleric and MP, told the Iraqi parliament. His warning suggests that the Shia leadership may be losing its grip over Shias who in private often call for an armed backlash against their Sunni assailants.

The United States knows that both Syria and Iran are covertly supporting the insurgency in hopes of defeating the Iraqi democracy, hoping to force the Americans to abandon this war. I am looking at the market with an eye toward the possibility that a war involving Iran and Syria can take place at any time. This is a very threatening situation that shouldn't be minimized. This situation will keep crude oil prices elevated. It represents a serious threat to the supply of oil. We face a very tricky and dangerous period ahead.

Sector selection takes center stage right now. Recently, sector rotations have been vicious, swinging back and forth, and what is strong now may be weak in a very short time. This rally may last until about mid-August before momentum peters out. The period of mid-August through September is one of the weakest time periods of the year. We are grossly overbought on an intermediate basis, and that can last longer than expected, but it does set the market up for profit taking soon.

I have a hard time believing that the OTC market can continue to race ahead if crude oil prices break above $62.80 a barrel. We are at $60 a barrel now, so a new high in oil prices could spark another scary sector rotation out of growth stocks again. The problem here is sustainability. In the meantime, the financial sector is looking very scary, feeling the effects of the danger of the situation of a flat yield curve.

It appears to me that energy stocks are heading higher, but here again, the Fed is tightening, so some pretty steep corrections could materialize. The health-care sector is feeling the effects of the surge in growth stocks as investors allocate out of more defensive issues into more growth-oriented stocks. I look for this sector to get stronger by mid-August. Meanwhile, the real estate stocks are plowing ahead. Our REIT positions have been trending higher. Continue to hold them, but be faithful to your stops. This is not a low-risk environment–so I will continue to be raising cash over the next several weeks.

MONTHLY PORTFOLIO TRACKER

The portfolios listed below are based on our exclusive ranking. Our ranking is primarily based on a 10,000 stock universe that have the highest combination of inherent value, stability and relative performance. Each of the 10,000 stocks are ranked on a rating of 1 (lowest) to 10 (highest). Only stocks ranked 7 or above make it to our portfolio. Due to the rapid changes in the stock market please call our **Hotline 1–512–703–8088 (PIN 0521)** Monday evenings for weekly updates. Each portfolio is based on a starting balance of $50,000.

INCOME

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	7/31/05 PRICE	TOTAL RETURN	STOP	INDUSTRY
5/24/05	190	RNP	Cohen & Steers (ETF)	$26.36	$27.75	5.27%	$25.50	REIT
5/24/05	145	ACAS	American Cap. Strategies	$34.56	$37.63	8.88%	$35.00	Financial
5/24/05	449	HIH	Highland Hospitality	$11.13	$12.10	8.72%	$10.50	REIT
6/7/05	225	BMR	Biomed Realty Trust	$22.20	$25.43	14.55%	$23.00	REIT
6/14/05	215	POM	Pepco Holdings	$23.25	$23.97	3.10%	$22.00	Utility

50% Money Market

GROWTH & INCOME

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	7/31/05 PRICE	TOTAL RETURN	STOP	INDUSTRY
5/24/05	120	NDE	Indymac Bancorp	$41.64	$43.61	4.73%	$41.64	Financial
6/7/05	348	FICC	Fieldstone Invest	$14.35	$14.64	2.02%	$13.00	REIT
6/7/05	125	GGP	General Growth Prop	$40.03	$45.98	14.86%	$41.00	REIT
6/7/05	189	UGI	UGI Corp	$26.52	$29.34	10.63%	$27.00	Utility
6/14/05	442	SFC	Spirit Finance	$11.30	$11.76	4.07%	$10.75	REIT

50% Money Market

MODERATE

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	7/31/05 PRICE	TOTAL RETURN	STOP	INDUSTRY
7/6/05	72	STR	Questar Corp	$69.70	$70.18	0.69%	$63.00	Petroleum
7/6/05	77	BG	Bunge Limited	$64.93	$61.39	-5.45%	$60.00	Food

80% Money Market

AGGRESSIVE

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	7/31/05 PRICE	TOTAL RETURN	STOP	INDUSTRY
5/24/05	289	CTV	Commscope Inc.	$17.30	$16.89	-2.37%	$16.50	Telecom
6/7/05	325	WDC	Western Digital	$15.38	$14.39	-6.44%	$12.00	Computer
7/6/05	152	FTO	Frontier Oil	$33.00	$28.02	-15.09%	$25.00	Petroleum
7/6/05	405	LUB	Luby's	$12.34	$14.10	14.26%	$12.50	Resturant

60% Money Market

TRADING PORTFOLIO

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STEALTH STOCKS' WATCH LIST

The Stealth Composite is a combination of three factors: inherent value, relative performance and growth and stability of earnings. These stocks are selected from a universe of 10,000 stocks in our database. Each of the 10,000 stocks are ranked on a rating of 1 (lowest) to 10 (highest). These stocks are on our watch list and depending on certain factors could very shortly be added to our portfolios.

RANK	STOCK	SYMBOL	INDUSTRY	STEALTH COMPOSITE	1–MONTH RETURN
1	K B Home	KBH	Building (Residental)	7.6	8.0%
2	D R Horton	DHI	Building (Residental)	7.6	9.5%
3	Gehl Co	GEHL	Machinery (Farm)	7.6	26.0%
4	Florida Rock	FRK	Building (Cement Etc.)	7.5	11.9%
5	Lowes Cos	LOW	Retail (Building Prds)	7.5	13.7%
6	Wireless Xcess	XWG	Telecomm (Cellular)	7.5	114.4%
7	Best Buy	BBY	Retail (Consumer Elect)	7.5	12.0%
8	Forward Indus	FORD	Personal (Consumer Prds)	7.5	67.3%
9	Luby's Inc.	LUB	Food (Resturant)	7.5	19.4%
10	Abercrombie	ANF	Retail (Apparel)	7.4	4.8%
11	Lennar Corp A	LEN	Building (Residental)	7.4	6.0%
12	Lufkin Inds	LUFK	Petroleum (Mach\Equip)	7.4	35.7%
13	Building Mtls	BMHC	Building (Products)	7.4	21.2%
14	Pulte Homes Inc	PHM	Building (Residental)	7.4	11.2%
15	Empire Resources	ERS	Metal Prds (Distributors)	7.3	28.0%
16	Helmrch & Payne	HP	Petroleum (Drilling)	7.3	21.9%
17	Todco	THE	Petroleum (Drilling)	7.3	19.9%
18	AFLAC Inc	AFL	Insurance (Acc\Health)	7.3	4.1%
19	Atrion Corp	ATRI	Healthcare (Products)	7.3	7.0%
20	Centex Corp	CTX	Building (Residental)	7.3	4.7%
21	Ensco Int'l	ESV	Petroleum (Drilling)	7.3	13.1%
22	Graham Corp	GHM	Machinery (Industrial)	7.3	28.1%
23	Intuitive Srgl	ISRG	Healthcare (Instruments)	7.3	46.0%
24	N V R Inc.	NVR	Building (Residental)	7.3	15.1%
25	Parlux Fragrance	PARL	Personal (Cosmetics)	7.3	14.9%

STOCK OF THE MONTH:

Gehl Co. (NASDAQ: GEHL)

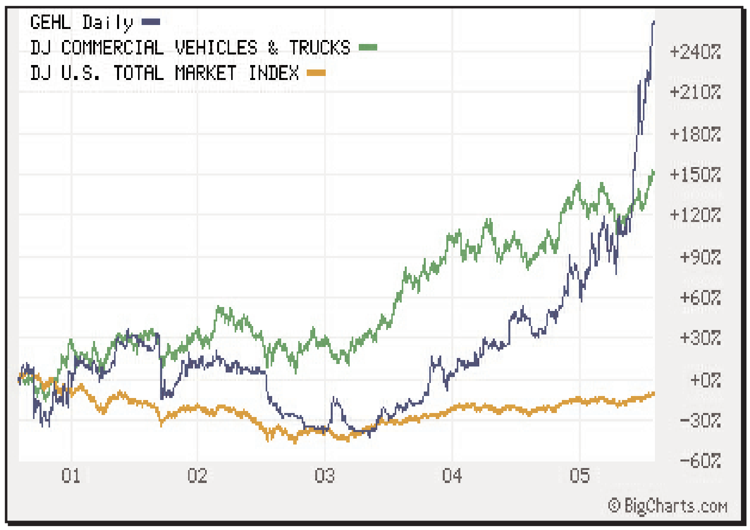
Market Cap – $332 million — Shares Outstanding – 6.8 million — Buy Below – $56/share

Company Profile

Gehl Co. manufactures and distributes agricultural and light construction equipment. Sales in 2004 were derived as follows: construction equipment 67% and agricultural equipment 33%. Construction equipment accounted for 93% of income from operations in 2004, and agricultural equipment for 7%.

Construction equipment is marketed in seven product areas: skid loaders (used primarily for material-handling functions), telescopic handlers (designed to lift heavy loads), asphalt paving equipment (used by contractors, subcontractors, owner operators, and municipalities), compact excavators, compact loaders, all-wheel-steer loaders, and compact track loaders. Construction equipment is manufactured in two South Dakota facilities. GEHL maintains a separate distribution system for construction equipment. At December 31, 2004, the company marketed its equipment through 310 independent dealers (with 1,145 outlets) and worldwide through about 100 distributors.

Weekly prices of Gehl Co. (NASDAQ: GEHL)



Agricultural equipment is marketed in five areas: haymaking, forage harvesting, materials handling (skid loaders, telescopic handlers, compact excavators, mini-loaders, and attachments), manure handling, and feedmaking. Agriculture equipment is sold to the dairy and livestock industries. The company believes it is one of the largest nontractor agricultural equipment manufacturers in North America. It has manufacturing facilities in Wisconsin and South Dakota. In 2004, agricultural equipment was sold in North America through about 355 dealers (with 415 outlets); 50 dealers are located in Canada. Equipment is also marketed through 15 distributors in Europe, the Middle East, the Pacific Rim, and Latin America.

At December 31, 2004, the backlog of unfilled equipment orders was valued at $65.3 million, up from $38.9 million a year earlier. Sales are seasonal, with the second and third quarters historically producing the strongest sales. (Source: www.businessweek.com.)

Why I like it

GEHL has little debt and has a current ratio (assets to liabilities) of over 3. That means the company has three times as many current assets as liabilities, a financially healthy position. Revenue has been at 12% per annum over the past three years, and earnings per share have soared more than 240% during that same time period. On July 25, it reported record sales and a three-for-two stock split. The way I see it, GEHL is just trading too low based on my calculations of its fair value.

Projection

According to my numbers, this is a stock that should be selling in the high $90s to low $100s over the next three to five years. It is currently trading in the high $40s, so GEHL has a large upside potential. Place a sell stop at 25% below your entry price. As the stock rises, continue to raise your stop so that you are trailing the Friday close by 25%.

Contact Info: **Gehl Co. (GEHL)** • 143 Water Street • West Bend, WI 53095
Phone: 262-334-9461 • **www.gehl.com**

FIVE STOCKS THAT COULD DOUBLE IN A YEAR

1. **SUPERGEN, INC. (SUPG) $7 —** SuperGen, Inc., engages in the development and commercialization of therapies for solid tumors, hematological malignancies, and blood disorders. Its principal products include Nipent (pentostatin) for injection, Orathecin (rubitecan) capsules, and Dacogen (decitabine) for injection. Nipent is approved and marketed in the United States for the treatment of hairy cell leukemia.

2. **MYOGEN, INC. (MYOG) $11 —** Myogen, Inc., a biopharmaceutical company, engages in the discovery, development, and commercialization of small-molecule therapeutics for the treatment of cardiovascular diseases. It markets an intravenous formulation of enoximone, Perfan I.V., in Europe for the treatment of acute decompensated heart failure.

3. **VAALCO ENERGY, INC. (EGY) $4 —** VAALCO Energy, Inc., engages in the acquisition, exploration, development, and production of crude oil and natural gas. The company's properties and exploration activities are located in the Texas Gulf Coast region and offshore Gabon, West Africa. As of December 31, 2004, it had total proved reserves of 8,734 million barrels of crude oil and 54 million cubic feet of natural gas. The company is based in Houston, Texas.

4. **BELL MICROPRODUCTS, INC. (BELM) $10 —** Bell Microproducts, Inc., distributes storage products and systems, as well as semiconductor and computer products and peripherals to original equipment manufacturers, value-added resellers, and dealers in the United States, Canada, Europe, and Latin America. It offers components that include disk drives, semiconductors, flat-panel displays and related products, and other storage products and custom-configured computer products.

5. **EARLE M. JORGENSEN CO. (JOR) $9 —** Earle M. Jorgensen Company (EMJ) distributes metal bar and tubular products in North America. The company offers various products, including carbon, alloy, and stainless steel and aluminum bars. It provides metal processing services, such as cutting to length, burning, sawing, honing, shearing, grinding, and polishing.

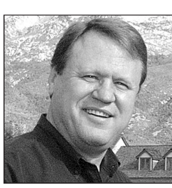
ON A PERSONAL NOTE

Over the past few weeks, the stock market has been giving investors a good ride. It reminds me of going on a roller coaster with my grandchildren. The climb to the top is slow and beautiful. I always admire the beautiful scenery and the way I can literally see for miles. And then it happens. It starts very slowly at first, but before I know it, we are hurtling downward at close to 80 mph.

As your editor, my job is to make you aware of where we are in the roller-coaster cycle; are we still approaching the top, or are we about to hurtle downward? Right now we are getting pretty close to a critical juncture in the stock market. Remember to place your stops and get ready to raise cash. I don't want you to lose hard-earned assets when the market begins to go down.

Until next month,

Dennis Slothower
Editor, Stealth Stocks



Dennis Slothower is a veteran financial analyst, widely read author and popular speaker. He is the editor of Stealth Stocks and On the Money (for mutual fund trading). Dennis is consistently ranked as one of America's top five investment advisors by the fiercely independent Hulbert Financial Digest. Dennis invites you to write him by mail or send him an e-mail at support@StealthStocksOnline.com