

SupplySideInvestor

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Inflation Worries for the New Year

Given the significant rally in gold to over \$540/oz., we are concerned that upside surprises this year in CPI and PCE measures will persuade committee members to keep a "tight" monetary policy for most of 2006.

[Excerpts from Polyconomics Institutional Research Service]

The strength in financial markets is largely due to the expectation that the Fed will finally stop raising the funds rate around the 4.5-4.75% level. At this level, we expect the yield curve to invert or remain extremely flat because the long-end is, as we continue to argue, naturally "heavy." How long will the Fed hold a flat to inverted yield curve in 2006? Given the significant rally in gold to over \$540/oz., we are concerned that upside surprises this year in CPI and PCE measures will persuade committee members to keep a "tight" monetary policy for most of 2006. Consequently, we do not expect any cuts in the funds rate.

We arrived at this conclusion based on a new path-breaking analysis of gold's monetary forecasting ability. Sean Breen, who has worked with Polyconomics in the past and has continued a corresponding relationship, created an econometric model that uses movements in the price of gold to predict the CPI and core PCE deflator up to six months in advance. With gold trading between \$420/oz and \$500/oz in the last six months and the expectation of a 10-year Treasury yield between 4.5% and 4.9% (according to the six month futures market), Sean's model forecasts a 4.0% CPI and a 2.1% PCE by June 2006, well above the current

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Polyconomics & SupplySideInvestor were founded by Jude Wanniski.

CPI and PCE measures of 3.5% and 1.8% respectively. The model's expected margin of error is +/- 0.14% for the PCE and +/- 0.34% for the CPI.

If these predictions turn out to be accurate, the closely watched PCE would hover in a range that Ben Bernanke, based on his speech last March to the Executives' Club of Chicago, has considered outside his "comfort zone." Consequently, the next Fed Chairman can no longer be counted on to provide a dovish or rate-cutting approach to policy next year, which would aid GDP growth at the margin. Instead, it is more realistic to expect Bernanke and the FOMC to keep a tight monetary posture during 2006, keeping in place a flat to inverted yield curve.

We have seen no indication yet that Bernanke would correctly remove excess dollar liquidity by selling Treasuries to pull gold down to \$400, our most comfortable range. Doing so would immediately remove the incipient inflation drag on the economy and reduce inflation premiums in bonds. Hopes that Bernanke will announce such an approach are wishful thinking for now.

Certainly, the absence of rate cuts in 2006 will be a disappointment for those of us counting on a strong resurgence in growth to absorb the excess liquidity in the economy. If Bernanke refrains from a "pro-growth" policy of interest rate cuts, the next best thing he could do is to definitively announce an end to the current rate hike campaign. This would slightly improve both the economic and monetary outlook by reducing risk of continued Fed mismanagement. At the margin, demand for dollars would increase, restraining the rising gold price. Businesses would be better able to forecast and plan for the next 1-2 years, spurring a little more production at the margin than we've seen in the last 18 months.

* * *

Current Top/Bottom Sectors by Score

Rank	Sector	Score	Rank	Sector	Score
1	Aluminum	13.0	96	Oil Services	1.5
2	Paper/Forest Products	13.0	97	REITs - office	1.5
3	Computer Hardware	12.0	98	Pharmaceuticals	1.0
4	Metals – misc.	12.0	99	HMO's	1.0
5	Ad Agencies	11.0	100	Airlines - Major	1.0
6	Semiconductors	10.5	101	REITs - retail	0.5
7	Machinery – div.	10.0	102	Cable	0.5
8	Employment Agencies	10.0	103	Gold Stocks	0.0
9	Software Applications	10.0	104	Hospital Mgmt.	0.0
10	Consulting Firms	10.0	105	Prop/Cas. Insurance	-0.5

[Sectors are scored according to appropriate macroeconomic factors (on a scale of -5 to +5). Each factor is then weighted. All factors are added together in the calculation of a total score for the sector.]

Sector Rankings – The current top & bottom sector rankings imply a balanced investment approach between value and growth, with a modest upside bias in the marketplace. Aluminum, paper/forest products, metals, and timber products represent value, old-economy investments, while semiconductors, software and ad agencies represent a growth-oriented style. The model does not present us with any attractive short candidates.

Previous Rankings Before Last Change on July 6, 2005

Rank	Sector	Score	Rank	Sector	Score
1	Aluminum	17.0	96	REITs – industrial	2.0
2	Paper/Forest Products	16.0	97	Airlines-Domestic	2.0
3	Metals – misc.	15.0	98	Utilities – nuclear	1.5
4	Building Materials	14.0	99	Airlines – Major	1.5
5	Timber Products	13.0	100	HMO's	1.0
6	Computer Hardware	13.0	101	Hospital Mgmt.	0.0
7	Semiconductors	12.5	102	REITs – office	0.0
8	Machinery – div.	12.0	103	REITs – retails	-1.0
9	Advertising Agencies	12.0	104	Cable	-1.0
10	Agribusiness	11.0	105	Prop/Cas. Insurance	-1.5

Sectors We Score

Sectors are scored according to appropriate macroeconomic factors (on a scale of -5 to +5). Each factor is then weighted. All factors are added together in the calculation of a total score for the sector. Below is a complete list of the 105 sectors we score.

Advertising Agencies	Coal mining	Insurance / Multi-Line	Pharmaceuticals	Specialty printing
Aerospace	Comp. hardware	Insurance brokers	Private mail services	Steel
Agribusiness	Consulting firms	Internet - ecommerce	Processed foods	Supermarkets
Airlines - domestic	Containers	Internet - ISP	Prop/cas insur.	Telecom Equipment
Airlines-Major	Cosmetics	Investment Banks	Railroads	Telephone - cellular
Aluminum	Credit Card Issuers	Life insurance	REITs - Apartment	Telephone - RBOCS
Apparel	Defense Contractors	Local newspapers	REITs - healthcare	Telephones - Long Dist.
Asset mgmt.	Domestic appliances	Lodging	REITs - industrial	Textiles
Auto parts & equip	Elect. Equip/instr.	Machinery -- div.	REITs - office	Timber Products
Automobiles	Employment agencies	Medical products	REITs - retail	Tobacco
Banks - Custodial	Eng. & constr.	Merchant generators	Restaurants - multi-national	Toys
Banks - money center	Entertainment	Metals -- misc.	Restaurants - U.S.	Trucking/Logistics
Banks - Regional	Food/drug distrib	National newspapers	Retailers -- apparel	Trucks and Parts
Banks - Super-regional	Footwear	Natural gas	Retailers -- dept. stores	Utilities - Non-Nuclear
Beverages - alcoholic	Furniture	Ocean shipping	Retailers -- drug	Utilities - Nuclear
Beverages - soft drink	Garbage hauling	Office equip.	Retailers -- general	
Book/mag publishing	Gold stocks	Oil - downstream bias	Retailers -- specialty	
Broadcast media	Hardware & tools	Oil -- upstream bias	Savings and loans	
Brokers	HMOs	Office equip.	Security services	
Building materials	Homebuilding	Oil Majors	Semiconductors	
Cable	Hardware & tools	Oil services	Software - applications	
Casinos	Hospital mgmt	Paper / Forest Products	Software - Comms	
Chemicals	Household prods.	Personal loans	Software - Entertainment	

SUPPLYSIDEINVESTOR EXCHANGE TRADED FUND (ETF) LIST

Given the macroeconomic and political environment, we consider the following exchange traded funds among the most attractive investments within the ETF universe. For your reference, this list will be updated with each issue of SupplySideInvestor.

OPEN POSITIONS	TICKER	Name	Date Rec.	Rec. Price	Last Price*	Gain/Loss**	Year to Date Returns**
Sector - Longs							
Benchmark Index	IYW US EQUITY SPX INDEX	ISHARES DJ US TECHNOLOGY SEC Standard & Poors 500 Index	7/11/2005 7/11/2005	47.66 1219.44	53.22 1289.69	11.67% 5.76%	4.78% 1.65%
Benchmark Index	IYM US EQUITY SPX INDEX	ISHARES DJ US BASIC MATERIAL Standard & Poors 500 Index	11/29/2004 11/29/2004	50.48 1178.57	53.52 1289.69	6.02% 9.43%	1.50% 1.65%
Benchmark Index	SMH US EQUITY SWH US EQUITY SPX INDEX	SEMICONDUCTOR HOLDRs TRUST SOFTWARE HOLDRs TRUST Standard & Poors 500 Index	9/27/2004 9/27/2004 9/27/2004	29.8 34.1 1103.52	39.80 38.68 1289.69	33.56% 13.43% 16.87%	4.96% 1.87% 1.65%
Global - Longs							
Benchmark Index	FXI US EQUITY EWJ US EQUITY MXEA INDEX	ISHARES FTSE/XINHUA CHINA 25 ISHARES MSCI JAPAN INDEX FD Morgan Stanley Capital International EAFE Index	12/28/2005 12/28/2005 12/28/2005	62.04 13.6 1695.05	66.14 14.00 1763.64	6.61% 2.94% 4.05%	5.00% 0.36% 2.86%
Benchmark Index	CEE US EQUITY MXEA INDEX	CENTRAL EUROPE & RUSSIA FUND Morgan Stanley Capital International EAFE Index	7/25/2005 7/25/2005	34.00 1499.70	45.52 1763.64	33.88% 17.60%	4.28% 2.86%
Benchmark Index	IIF US EQUITY MXEA INDEX	MORGAN STANLEY INDIA INVEST Morgan Stanley Capital International EAFE Index	11/29/2004 11/29/2004	26.16 1459.73	41.95 1763.64	60.36% 20.82%	6.20% 2.86%
Benchmark Index	EWO US EQUITY EWZ US EQUITY EWW US EQUITY MXEA INDEX	ISHARES MSCI AUSTRIA Index ISHARES MSCI BRAZIL ISHARES MSCI MEXICO Index Morgan Stanley Capital International EAFE Index	9/27/2004 9/27/2004 9/27/2004 9/27/2004	17.7 17.94 20.13 1300.57	29.04 36.94 37.86 1763.64	64.07% 105.91% 88.08% 35.61%	1.54% 6.06% 1.75% 2.86%

CLOSED POSITIONS	TICKER	Name	Date Rec.	Rec. Price	Last Price*	Gain/Loss
Sector						
CLOSED 7/11/05	IAH US EQUITY SPX INDEX	INTERNET ARCHITECT HOLDRs TR Standard & Poors 500 Index	12/23/2004 12/23/2004	37.68 1194.20	37.11 1289.69	-1.51% 8.00%
CLOSED 11/29/04	RKH US EQUITY SPX INDEX	REGIONAL BANK HOLDERS TRUST Standard & Poors 500 Index	9/27/2004 9/27/2004	132.15 1103.52	139.09 1178.57	5.25% 6.80%
CLOSED 12/10/04	OIH US EQUITY	OIL SERVICE HOLDRs TRUST	9/27/2004	81.08	81.12	0.05%
CLOSED 12/10/04	IXC US EQUITY SPX INDEX	ISHARES S&P GLBL ENERGY SECT Standard & Poors 500 Index	9/27/2004	69.56 1103.52	72.48 1188.00	4.20% 7.66%
Global						
CLOSED 7/25/05	TKF US EQUITY MXEA INDEX	TURKISH INVESTMENT FUND Morgan Stanley Capital International EAFE Index	12/23/2004 12/23/2004	15.95 1493.64	17.36 1763.64	8.84% 18.08%
CLOSED 12/9/04	TRF US EQUITY MXEA INDEX	TEMPLETON RUSSIA & EAST EURO Morgan Stanley Capital International EAFE Index	9/27/2004	37.28 1300.57	37.62 1439.81	0.91% 10.71%
CLOSED 12/23/04	EWC US EQUITY MXEA INDEX	ISHARES MSCI CANADA Morgan Stanley Capital International EAFE Index	9/27/2004	15.07 1300.57	16.76 1493.64	11.21% 14.85%

* Last Price reflects the last available closing price on the date of issue publication (1/10/2006).

** Performance does not include dividend distributions.

Note: The SupplySideInvestor 'ETF List' is not a model portfolio. It is a list of ETFs that are believed to be among the most attractive investments through ETF investing, based on Polyconomics' assessment of the economic and political landscape. SupplySideInvestor staff may hold positions in some or all of the funds listed.

Note to Investors

With the recent changes to our portfolio recommendation service, we are highlighting the advantages of Exchange-Traded Funds (ETF's), and how they can be effectively used in conjunction with our macroeconomic and political analytics.

ETF's are baskets of securities that are traded like individual stocks on an exchange. They can be country-specific, sector-specific, or broad-market specific. Unlike traditional open-end mutual funds, ETF's can be bought and sold anytime during the trading day, and generally have much lower expense ratios.

We believe exchange-traded funds can be especially suited for individual subscribers as our research primarily focuses on the macroeconomic and political effects on countries and industries, rather than specific companies. If our recommendations are bullish or bearish, for example on Brazil or semiconductors, subscribers can easily long or short those general investment themes via Brazil iShares (EWZ) or Semiconductor Holder's (SMH). By their nature, ETF's mitigate company-specific risk while enhancing industry-specific reward. Yahoo! Finance's ETF Center -- <http://finance.yahoo.com/etf> -- is an excellent source for ETF news and information. ETF information can also be found in the pages of the Wall Street Journal and Barron's.

We believe that ETF investing fits in well with our investment philosophy and provides SupplySideInvestor subscribers with a superior approach to investing via our analytical framework. Where corresponding ETFs do not exist, bellwether companies within given sectors can often be located through Yahoo! Finance <http://biz.yahoo.com/ic/> and for information relating to ADRs, in conjunction with our global macro research, www.adr.com is an excellent online resource.

THE ETF UNIVERSE

SECTOR/INDUSTRY

HOLDRs	
Ticker	Name
BHH	B2B INTERNET HOLDRS TRUST
OIH	OIL SERVICE HOLDRS TRUST
HHH	INTERNET HOLDRS TRUST
IHH	INTERNET INFRASTRUCTURE HOLD
SWH	SOFTWARE HOLDRS TRUST
WMH	WIRELESS HOLDRS TRUST
UTH	UTILITIES HOLDRS TRUST
TTH	TELECOM HOLDRS TRUST
BDH	BROADBAND HOLDRS TRUST
RTH	RETAIL HOLDRS TRUST
RKH	REGIONAL BANK HOLDERS TRUST
SMH	SEMICONDUCTOR HOLDRS TRUST
IAH	INTERNET ARCHITECT HOLDRS TR
BBH	BIOTECH HOLDRS TRUST
PPH	PHARMACEUTICAL HOLDRS TRUST

iShares	
Ticker	Name
IGE	ISHARES GOLDMAN SACHS NAT RE
IYE	ISHARES DJ US ENERGY SECTOR
IGV	ISHARES GOLDMAN SACHS SOFTWA
IYT	ISHARES DJ US TRANSPORT INDX
IYM	ISHARES DJ US BASIC MATERIAL
IYZ	ISHARES DJ US TELECOMMUNICAT
IDU	ISHARES DJ US UTILITIES SECT
IYW	ISHARES DJ US TECHNOLOGY SEC
ICF	ISHARES COHEN & STEERS RLTY
IYR	ISHARES DJ US REAL ESTATE
IYC	ISHARES DJ US CNSMR SERVICE
IGW	ISHARES GOLDMAN SACHS SEMI
IYJ	ISHARES DJ US INDUSTRIAL SEC
IGN	ISHARES GOLDMAN SACHS NETWORK
IYF	ISHARES DJ US FINANCIAL SECT
IBB	ISHARES NASDAQ BIOTECH INDX
IYK	ISHARES DJ US CONSMR GOODS
NEW!!	
GLD	STREETTRACKS GOLD TRUST

Fixed Income

iShares	
Ticker	Name
AGG	ISHARES LEHMAN AGG BOND FUND
TIP	ISHARES LEHMAN TRES INF PR S
SHY	ISHARES LEHMAN 1-3YR TRS BD

iShares	
Ticker	Name
IEF	ISHARES LEHMAN 7-10YR TREAS
TLT	ISHARES LEHMAN 20+ YR TREAS
LQD	ISHARES GS\$ INVESTOP CORP BD

INTERNATIONAL

Closed-End Funds	
Ticker	Name
TRF	TEMPLETON RUSSIA & EAST EURO
MXE	MEXICO EQUITY AND INCOME FD
SOA	SOUTHERN AFRICA FUND INC
LDF	LATIN AMERICAN DISCOVERY FD
RNE	MORGAN STANLEY EAST EUROPE
LAQ	LATIN AMERICA EQUITY FD INC
MXF	MEXICO FUND INC
BZF	BRAZIL FUND INC
SNF	SPAIN FUND INC
KF	KOREA FUND
IRL	NEW IRELAND FUND INC
SGF	SINGAPORE FUND INC
KEF	KOREA EQUITY FUND
CEE	CENTRAL EUROPE & RUSSIA FUND
BZL	BRAZILIAN EQUITY FUND
JOF	JAPAN SMALLER CAPITALIZATION
APF	MORGAN STANLEY ASIA PACIFIC
GF	NEW GERMANY FUND
TKF	TURKISH INVESTMENT FUND
EF	EUROPE FUND INC
CH	CHILE FUND
SWZ	SWISS HELVETIA FUND
ISL	FIRST ISRAEL FUND INC
IFN	INDIA FUND INC
GRR	ASIA TIGERS FUND INC
TWN	TAIWAN FUND INC
MF	MALAYSIA FUND INC
APB	ASIA PACIFIC FUND INC
JEQ	JAPAN EQUITY FUND
SAF	SCUDDER NEW ASIA FUND INC
TFC	TAIWAN GREATER CHINA FUND
GER	GERMANY FUND
IF	INDONESIA FUND INC
TDF	TEMPLETON DRAGON FUND INC
IIF	MORGAN STANLEY INDIA INVEST
TTF	THAI FUND INC
TF	THAI CAPITAL FUND INC
GCH	GREATER CHINA FUND
CHN	CHINA FUND INC
JFC	JF CHINA REGION FUND INC

iShares	
Ticker	Name
EWZ	ISHARES MSCI BRAZIL
EWA	ISHARES MSCI AUSTRALIA INDEX
EWC	ISHARES MSCI CANADA
ILF	ISHARES S&P LATIN AMERICA 40
IXC	ISHARES S&P GLBL ENERGY SECT
EWD	ISHARES MSCI SWEDEN INDEX FD
EPP	ISHARES MSCI PACIFIC EX JPN
EWV	ISHARES MSCI MEXICO
EWO	ISHARES MSCI AUSTRIA INDEX
EWK	ISHARES MSCI BELGIUM
EZA	ISHARES MSCI SOUTH AFRICA IN
EWI	ISHARES MSCI ITALY INDEX FD
EWP	ISHARES MSCI SPAIN INDEX FD
EWG	ISHARES MSCI GERMANY INDEX
EWU	ISHARES MSCI UNITED KINGDOM
EZU	ISHARES MSCI EMU
IEV	ISHARES S&P EUROPE 350
EFA	ISHARES MSCI EAFE INDEX FUND
EWY	ISHARES MSCI SOUTH KOREA IND
EWQ	ISHARES MSCI FRANCE INDEX FD
IXG	ISHARES S&P GLBL FINL SECTOR
EWS	ISHARES MSCI SINGAPORE
IXN	ISHARES S&P GLBL TECH SECTOR
EWN	ISHARES MSCI NETHERLANDS INX
EWB	ISHARES MSCI HONG KONG INDEX
EWT	ISHARES MSCI TAIWAN INDEX FD
ITF	ISHARES S&P/TOPIX 150 INDEX
EWJ	ISHARES MSCI JAPAN INDEX FD
EWM	ISHARES MSCI MALAYSIA
IOO	ISHARES S&P GLOBAL 100
EWL	ISHARES MSCI SWITZERLAND IND
IXJ	ISHARES S&P GLBL HEALTHCARE
NEW!!	
FXI	ISHARES FTSE/XINHUA CHINA 25

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