

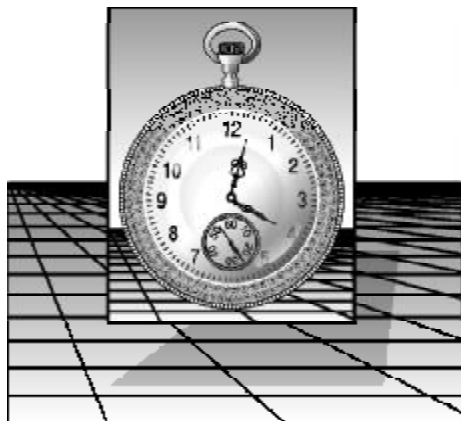
PROFESSIONAL TIMING SERVICE
Chris Hester

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The next issue will be
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Asset Allocation In A Low Return World

Key numbers to remember are: 85% of investment success is due to being in the right asset sector, and 15% is being in the right stocks. It should be apparent that asset allocation is where to begin in building an investment portfolio.

Asset allocation is usually defined by what your percentage allocation should be between stocks and bonds. However, it should be intuitive that this doesn't make complete sense. If the stock market crashes, high interest rates are often the culprit.

In that case, you are going to lose a lot of money in both bonds and stocks. In the event of a 1930's style depression where deflation is in force (not just an abatement in the rate of inflation), your bonds may do fine - assuming they pay off and are not issued by a company taken to bankruptcy in the debacle.

I have a model I call the Annual Asset Allocation Model (AAAM) to deal with the problem of asset allocation, but our model is not designed to determine a split between stocks and bonds. It is designed to define what the best asset class will be in the next year - that is, the asset class that offers investors the best reward potential with the lowest risk.

There will only be one answer - not a diversified smattering covering all the bases. There are only three possible outcomes, but these three outcomes do cover all the bases. The model can tell us that stocks are the best place to be ... or it can tell us to be in bonds. Both of these alternatives are, of course, what we call financial or paper assets. The AAAM can also point us to another direction, and that is tangible assets.

The model had been in bonds until October 2001 when it shifted from bonds to tangible assets. The implication was poignant. It was telling us that the best thing to do was leave all financial or paper assets and put our money into tangible assets. It was then that we intensified our interest in precious metals and energy.

There is, of course, an exception to the prohibition against financial assets by the signal in 2001. The exception is bonds or stocks that are advantaged by the rising price of tangible assets or commodities.

The shift in 2001 has been very profitable, indeed, and our stock selection has also been profitable. It has put the 85% odds of being in the right asset class with the 15% odds of being in the right stocks together for a 100% sweet deal.

Now what?

Let me say that the commodity bull market is far from over, and the price of all commodities are going much higher in terms of U.S. dollars through the balance of the decade. There will come a time when we will have to sell our long term precious metal and energy investments, but that time is far ahead of us.

I came by an interesting study by Donald Coxe at Jones Heward, www.jonesheward.com. He refers to what he calls “triple waterfalls.” In a nutshell, he says that the tripple waterfall takes place over three decades. Any decade will have a best-performing and worst-performing asset class. The best-performing asset class will experience one decade of bull market, followed by a decade of disappointment, and then a decade of despair.

A good example was precious metals in the 1980’s. There was a decade of bull market, replete with the basing period in the beginning, followed by steps of increasing belief, until the whole thing blew off in a fit of over enthusiasm.

The next ten years were fraught with disappointment as investors (most of whom bought very late in the bull cycle) hung on to those beliefs. Finally, after a good ten years of punishment, they despaired and sold out, never to return. Don Coxe’s triple waterfall was then complete.

The writeup I read goes into more detail and examples, but the process should be familiar to old timers. Gold

peaked in 1980 at \$850 an ounce and double bottomed 21 years later, in 2001. It was that year that our AAAM shifted us to tangibles and gold. The commodity market has been doing quite well ever since.

So far, gold is up 80% from those lows. There should be another five to six years to go, and we haven’t even begun to see the fits of bullishness we will see at the highs.

This argument follows for crude oil and the energy stocks as well, but that group has its own individual supply/demand idiosyncrasies. First, consider this. The first part of the triple waterfall includes a decade long bull market.

The decade of bullishness is further interesting, according to Coxe, in that once the first half is over, you have a clear vision of the second half. The best-performing asset classes in the first five years will be the best performing in the second five years.

This creates a bit of a conundrum for me, but there is no question that energy has been the big performer so far during this decade. Energy will be a huge money maker for the next five years as well.

Precious metals have also performed far better than the worst asset class during the first five years of the new millennium. Any guesses as to the worst class? Right – tech stocks. Thus, we can comfortably extrapolate that precious metals (and really, the whole raw material commodity complex) will do well for the rest of the decade. Tech stocks, on the other hand, are in the second waterfall

phase of disappointment. They have a long ways to fall yet. Just wait until the despair phase sets in.

The puzzle involves two other asset classes that have done rather well during the first five years of the decade, and they should continue to outperform during the second half of the decade. Those are real estate and ... bonds.

No one ever said that the markets are logical. In fact, they aren’t logical at all. If they were, everyone would be rich. I can buy into the real estate continuing on, although I am not all that excited about buying real estate.

I just looked at some property at Flathead Lake, a large lake just north of Missoula. One was a strip of land with 150 feet of lake frontage and three “tear down” buildings. The price was \$1 million! But, that was not the asking price. That was what was paid for it.

Three years ago, I looked at a piece almost next to it with 70 feet of frontage and thought \$250,000 was too much. Do you realize it was only in 1968 that Hershey raised the nickel Hershey chocolate bar to a dime? Well, things do change.

The second property I saw recently had 300 feet of frontage, rocks for a beach, was on an island that you can’t drive to, had a truly rustic “cabin,” and was priced at \$650,000. It is still for sale if you are interested. What do I know - maybe it will sell for \$1 million in a few years.

The point is that those of you in places like California may see these

prices as relative bargains. They may be “bargains” for now, and real estate will likely continue to climb, at least according to the triple waterfall theory. Nevertheless, buying at these prices offers plenty of risk compared to buying good income-producing energy trusts.

The bond market mystifies me when I consider that it, too, may continue to be a profitable asset class over the balance of the decade. The waterfall theory seems to imply that.

However, let’s get back to my definitive Annual Asset Allocation Model. It is specifically out of bonds. Although that means bonds may continue to make money, the model implies that the risk-to-reward balance is more of a gamble than investment.

Time will solve the bond and real estate puzzle. There are just too many positives in the commodity sector to ignore, and that is where the highest rewards lie with the lowest risk. That is where I want my money, and I think you should have yours there also.

It will come as no surprise that during the first ten bull years of the triple waterfall, there will be ups and downs. That is what markets do. However, everyone seems to want to buy and sell yesterday. You just can’t do that; but if you know the right asset class to buy, you can buy weakness. If you happen to be in techs (the wrong asset class), you can sell into strength.

We have just come out of the latest down swing in the precious metals; and, hopefully, you were able to use

that weakness to pick up some of the issues on our buy-and-hold list at the downside prices we recommended. Whether you did or not, time marches on and you need to know what to do now.

GOLD

Gold is encountering some problems as it approaches \$460. The highs set last December and March will be a barrier. Once those highs are tested and the profit-takers (spineless profit-takers, as my mentor used to say) take their money and run, the next move will be to \$500. In the meantime, have some gold in your portfolio, and hang on to it.

The complete list of our buy-and-hold stocks is on Page 6 of this letter, along with recommended downside buy prices. Put in “good ‘til cancelled” orders and wait. If I were to say which attract me the most today, they would be **Yamana** (AUY-AMEX-\$3.56), and **Barrick Gold** (ABX-NYSE-\$24.70).

I do expect to see the gold stocks take a hit with some brief profit-taking here, so don’t chase these issues. If you don’t own any gold, buy a little here. Then load up on Yamana if it falls back to \$3.10 and on Barrick if it pulls down to \$22.50. If you already have gold mining shares, these are the two at the top of my list to add to during weakness.

Our Rydex gold program is still only 25% invested, but we will be increasing that as gold pulls back some. I expect to see the XAU sneak on down to about 85, and that will offer us an opportunity to ramp up our

position. I will have specific instructions as to when, at what price, and how much to add on the hotline for traders interested in this program.

Kinross (KGC-AMEX-\$5.78) is still a sell at \$6.60. This one has been a disappointment, and we can easily use this money better elsewhere.

CRUDE OIL

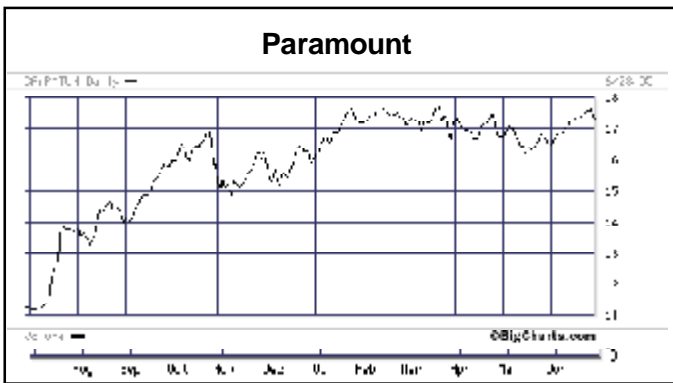
Crude oil hit \$60 in early June, and it has encountered some selling (as expected). I don’t have a good fix on just how far back crude might fall, but perhaps not all that much. From a technical perspective, a downside target of \$55 is not out of the question, but not cast in stone either.

I look for at least some sideways consolidation about the \$60.00 level basis December futures. Once profit-taking has run its course, the next move will be to \$65. I am looking for that by this fall.

There is always the caveat that something surprising can happen to dislocate supply, and that will spike oil sooner than expected. The bottom line is that although crude and natural gas may take a technical rest here, the surprises are more likely on the up side than the down side. Crude is going to hit \$65 and then move on to \$76 after another consolidation. It is not wise to bet on the down side in this sector.

What would I do with my money today?

Baytex (CA:BTEUN-TSX-C\$13.25) has been lagging the pack lately, but it does have an attractive dividend



of 13.5% at this price. My current downside buy price is C\$12.75. You can buy a bit here, and then add to that at C\$12.75. If you do not have any Baytex and hold other Canadian energy issues, buying a little Baytex at C\$12.75 will give you some diversification.

Another is **Paramount Energy** (CA:PMTUN-C\$17.33). It has been performing well (as you can see on the chart). My downside buy price is now C\$16.25, but you can purchase some here and it will provide a decent dividend of 15% while you wait. Buy some more if you get the chance at C\$16.25. You may or may not get that opportunity, but you can stand making 1.25% each month while you wait.

Natural gas is a biggie.

Crude oil gets all the headlines, but natural gas accounts for huge amounts of electrical generation and heat in the U.S. Domestic supplies are on the wane; and although natural gas can be imported in liquid form (LNG), there are not many ports that have the facilities to accept LNG ships. There are proposals in the works to construct LNG facilities in major ports, but the reception has been tepid at best.

to allow facilities at the federal government's behest. Putting aside the obvious ill will that the bill will create between the individual states and the Feds, those facilities are a long ways off.

The price of natural gas is currently \$7.05 July basis and over \$8.00 December basis. The price has been steadily rising lately, and I see \$12.00 natural gas in our near future. Paramount produces natural gas exclusively, and you should own a little.

DOLLAR

The U.S. dollar is holding up better than I would like; but I have to say, our Hyperion trading model has done a great job. It bought the dollar at 85.31 in May, and it has yet to give us a sell signal.

If you are trading the dollar, go with the signals. I still think the rally has been spent, and there has been precious little progress over the last few weeks. The Hyperion model will take profits now at 89.95 basis December, but that is not a signal to sell short, only to step to the sidelines.

Rydex just launched some new funds, among which are the

It boils down to a nimby (not in my back yard) outlook by the locals. The new energy bill that is being hammered out will likely force the states

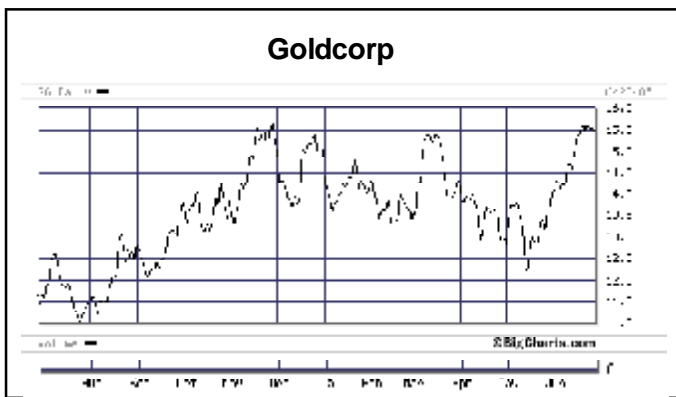
Strengthening Dollar (RYSBX) and **Weakening Dollar (RYWBX)** Funds. I am taking a look at how any of my dollar models - and the Hyperion model specifically - might work to trade these funds.

The excitement for me has been the Canadian dollar, or loonie. It has been on the rise versus the U.S. dollar of late. It bottomed at .7875 in May, and it just breached the .8100 level.

That is great news for our Canadian trusts. It means that a dollar in Canadian dividends was giving us 78-3/4 cents in U.S. dollars in May, but it is paying us over 81 cents now. Our dividends have increased in U.S. dollar terms by almost 3%, just on the currency shift. There will be more of this in the future as I expect to see the loonie eventually reach par with the U.S. dollar.

All of the stocks on the buy-and-hold list are purchase recommendations at their respective downside buy prices, but these are the ones that attract my eye right now. If you have been with us for some time, you have been advised to build positions in the energy and precious metal stocks for the last three years - ever since our AAAM shifted into tangibles.

We have some great initial positions and have been able to add to those with very little risk as time has moved on. It is now more apparent that energy, in particular, is the right place to be, but we are not at the ground floor any longer either. Nevertheless, with the next



five years expected to mirror the last five years, there is still plenty of money to be made in energy stocks.

It is no longer easy to find great looking stocks within the sector; and although 85% of the game may be the correct sector, we still would like to pay attention to that 15% of investment success that is attributed to individual stocks. So far, so good, but the hunt goes on. You will be the first to learn about anything new I find.

If you haven't been with us for long and perhaps just joined us, welcome. Trite as this is, Rome really wasn't built in a day, and neither are rich and profitable portfolios. It takes time and patience, and sometimes the ride can take your breath away.

Summer is here, and the summer rally will be disappointing for the tech followers. The second waterfall is still in progress from the great bull market of the 90's.

Energy has been discovered, but it isn't over yet. The world is not out of oil, but it is out of cheap oil .. and cheap coal .. and cheap natural gas. The precious metals have not been discovered yet,

ment lingers from the last decade, but shrewd investors - including shrewd corporate investors like **Goldcorp** (GG-NYSE-\$15.43) - have been buying tangible assets from those still too disappointed to see the extraordinary future that lies ahead for producers of raw materials. Goldcorp has always been one of my favorites.

Initially, I was not pleased with Goldcorp's merger with Wheaton, but that is why they are miners and I am an investment advisor. It is best to hire good management and then leave these decisions up to management. Goldcorp is finally on the move (as it should be), and I think it should be in everyone's portfolio.

If you don't own Goldcorp, you can nibble here and then add to your positions in weakness. My current downside buy price is \$13.75. The mining companies can be volatile - and again, I expect to see some profit-taking set in soon. Hold what you have, but use selling to add to your positions in Goldcorp at \$13.75.

We recommended buying the **Pimco Commodity Real Return Strategy Fund, B shares**, (PCRBX-\$15.66) in March at \$15.95. It backed off,

although the bull market in the metals (and commodity market in general) is just getting its feet under it.

The disappoint-

but not quite to our downside target of \$14.50. It has now recovered to \$15.66. It missed reaching our downside buy price by about 30 cents. No matter, that will happen sometimes.

We are still doing fine, and I think commodities in general will easily double from here by the end of the decade. I recommend that you hold your PCRBX, and I am going to stick with the \$14.50 downside buy price for now.

Along with the dollar funds mentioned above, Rydex has introduced a new **Commodity Fund** (RYMBX-\$26.97) that I am putting on my radar. It looks very interesting as a vehicle for trading and longer term investment. Put this on your list of things to watch, but I think you will like what we will be coming up with for this one.

Earning money in a low return world.

The odds favor tangible assets, and that is 85% of the game. The next five years promise to mirror the last five to a great extent, and that should point you to energy and commodities - to tangibles as our Annual Asset Allocation Model indicates.

Income is tough to come by these days, but our energy trusts will fill that bill very well. Combine the growth aspects of an awakening commodity bull market with income from energy and a dose of prudence. It is always wise to have some cash. Stick with what has worked for the last five years, and you will be very pleased with the next five.

Recommended Stocks For Buy And Hold

Note: If you go to www.bigcharts.com, you can get quotes on Canadian stocks in Canadian dollars by using the symbols we have listed, preceded by CA: For example, if you want a quote for Shiningbank, go to www.bigcharts.com and type in CA:SHNUN. You can approximate the price in U.S. dollars by multiplying the Canadian dollar quote by .810. You should buy at or below the posted downside buy price. Changes since our last posting are in bold letters.

Last Updated 6/28/05

Company	Symbol/ Exchange	Initial Recom. Date & Price	Price 6/28/05	Div.	Downside Buy Price	Target	Web Site
Enerplus Resources	ERF-NYSE	4/20/01@\$18.00	\$37.87	8.99%	HOLD		www.enerplus.com
Peyto Energy	PEYUN-TSX	7/18/03@\$C8.75	C\$29.46	4.89%	\$C26.75		www.peyto.com
Primewest Energy	PWI-NYSE	2/07/03@\$17.00	\$25.20	11.41%	\$23.25		www.primewestenergy.com
Provident Energy	PVX-AMEX	6/16/03@\$7.50	\$10.42	11.09%	\$9.75		www.providentenergy.com
Shiningbank	SHNUN-TSX	1/02/03@C\$15.15	C\$21.43	12.88%	C\$20.50		www.shiningbank.com
Suncor Energy	SU-NYSE	2/07/03@\$16.8	\$47.75	0.41%	\$38.50		www.suncor.com
Anglogold	AU-NYSE	2/25/03@\$32.00	\$35.16	n/a	\$32.50		www.anglogold.com
ASALtd.	ASA-NYSE	11/19/02@\$31.00	\$38.16	1.05%	\$35.50		www.asaltd.com
Goldcorp	GG-NYSE	8/15/03@\$13.00	\$15.43	1.17%	\$13.75		www.goldcorp.com
Newmont Mining	NEM-NYSE	9/05/03@\$39.10	\$38.62	1.04%	\$38.00		www.newmont.com
Barrick Gold	ABX-NYSE	1/05/03@\$22.85	\$24.70	0.89%	\$22.50		www.barrick.com
Baytex Energy	BTEUN-TSX	05/18/04@C\$11.90	C\$13.25	13.58%	C\$12.75		www.baytex.ab.ca
Alliance Res. Part.	ARLP-OTC	9/29/04@\$55.96	\$72.67	4.13%	\$65.00		www.arlp.com
Fording Cdn. Coal	FDG-NYSE	11/16/04@68.20	\$91.03	5.78%	\$85.00		www.fording.ca
Paramount En. Tr.	PMTUN-TSX	12/20/04@C\$16.44	C\$17.33	15.23%	C\$16.25		www.paramountenergy.com
Pimco Comod RR Str Fnd	PCRBX	3/2/05@\$15.95	\$15.66	n/a	\$14.50.		www.pimcofunds.com
Valero Energy	VLO-NYSE	4/26/05@\$73.25	\$76.54	0.51%	\$66.50		www.valero.com

****Peyto had a 2 for 1 split on 5/27.

Buy And Hold Junior Gold & Silver Stocks - The Option Alternative

Last Updated 6/28/05

Company	Symbol/Exchange	Initl. Recom. Date & Price	Price 6/28/05	Downside Buy Price	Target	Web Site
Kinross Gold Corp	KGC-AMEX	10/2/02@\$6.30	\$5.78	HOLD	\$6.60	www.kinross.com
Bema Gold Corp.	BGO-AMEX	6/6/02@\$1.06	\$2.29	\$2.00		www.bema.com
Coeur d'Alene	CDE-NYSE	9/2/03@\$3.19	\$3.42	\$3.15		www.coeur.com
Western Silver	WTZ-AMEX	9/2/03@\$3.50	\$8.70	\$8.10		www.westernsilvercorp.com
American Bonanza	BZA-V	10/2/02@C\$0.60*	C\$0.44	HOLD		www.americanbonanza.com
Ivanhoe Mines	IVN-NYSE	6/4/04@\$6.00	\$7.38	\$6.50		www.ivanhoe-mines.com
International Wayside	IWA-TSX	4/26/04@C\$0.14	C\$0.05	HOLD		www.wayside-gold.com
Novagold Resources	NG-AMEX	12/8/04@6.50	\$7.60	\$7.20		www.novagold.net
Yamana Gold	AUY-AMEX	4/14/05@2.90	\$3.56	\$3.10		www.yamana.com
Mines Management	MGN-AMEX	5/13/05@\$4.50	\$5.04	\$4.50		www.minesmanagement.com

*** American Bonanza had a 4 for 1 reverse split on 3/31/05

C\$ Denotes Canadian dollar

Quotes for Canadian stocks can be obtained on the U.S. OTC Bulletin Board (pink sheets) with the following symbols. I want to caution you, however, that OTCBB quotes are not always current. They can be a day or more old at times. You should take the quote in Canadian dollars (as described above) times .810 to see if the OTC quote looks correct. You can access these OTCBB quotes by using www.barchart.com. I don't have OTCBB symbols for American Bonanza or International Wayside.

Shiningbank SBKEF Peyto Energy PEYUF Baytex Energy BAYXF Paramount Energy PMGYF

Target The "Target" column represents the price at which you should liquidate the position and take profits. Do not reverse on the target price. There will not always be a target price. You should only reverse on the reversal stop price, even if there is no current open position.

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