Sand Spring Advisors LLC

Janus Revisited & Current Cycle Thoughts

by,

Barclay T. Leib

April 11, 2004

Sometimes people learn from bad experiences. Sometimes they do not – trying instead to avoid a new reality.

On January 21, 2001 we published an article entitled "*A Portfolio from Hell: Janus Dissected"* in which we queried how any reasonable portfolio manager could have possibly constructed (and any thinking investor have actually purchased) the Janus Fund portfolio of the time. Its simplistic focus on overpriced large-cap tech stocks was simply mind numbing:

Stock	P/E Jan 2001	Price - Jan 2001	P/E Today	Price Today	% Loss
AOL	100	**54**	26	**17.40**	-67.8%
Comcast	79	**44**	n/a	**29**	-34.1%
Linear Tech.	54	**62**	47	**39**	-37.1%
Boeing	23	**55**	46	**41**	-27.5%
Nokia	56	**39**	16	**17.10**	-56.2%
Cisco	94	**40**	39	**24**	-32.0%
Enron	46	**71**	n/a	**0**	-100.0%
Maxim Integrated	70	**69**	49	**49.40**	-28.4%
EMC Corp	117	**77**	59	**13**	-83.1%
Charles Schwab	47	**28**	102	**11**	-60.7%

Average Loss:					**-52.7%**

For a group that used to advertise its "in-depth research capabilities" by analysts climbing out of manholes after examining fiber optic cables underground, Janus's top picks of early 2001 have since declined by some -52.7%. By matter of comparison, over the same period, the S&P only fell by -15.9% and the NASDAQ 100 fell by -43.5%, while certain broader indices such as the Russell 2000 have actually risen. Of course, having a large-cap bias with Enron in the original mix did not help things for Janus.

As a conclusion to that January 2001 Sand Spring article, we proposed that Janus's parent holding company Stilwell Financial was itself a good short sale candidate at $47 a share. This entity (since renamed Janus Capital Group -- JNS) now trades at $16.63. This decline occurred partly as a result of the dumb portfolio management described above hitting the onset of a bear market, but also from the added impact of the recent mutual fund trading scandal – something that Janus currently remains in settlement discussions to resolve. The collapse of Janus also transpired despite persistent recommendations from the financial analyst community that Janus was "a potential turnaround value stock with a great brand name" -- chatter that to this day we continue to ignore.

And as Janus investors' wealth halved and its own assets under management dwindled, has Janus learned any lessons from its past three-year malaise?

Looking at their current portfolios, we don't think so.

A quick look at The Janus Fund's top 10 holdings list still shows no less than <u>five</u> of the same old names:

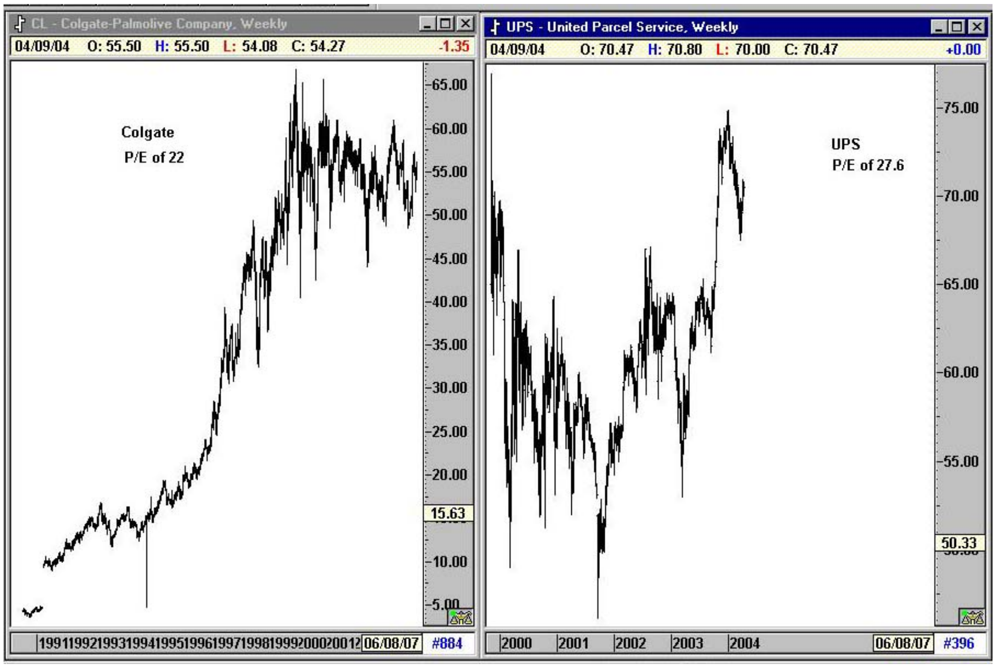
<u>The Janus Fund as of 3/31/04:</u>

Comcast	7.2% of assets
Maxim Integrated Products	6.3% of assets
Linear Technology	6.2% of assets
Time Warner (ex-AOL)	6.1% of assets
Cisco Systems	4.1% of assets

To this list, the portfolio manager has now added:

Univision Communications	3.2% of assets
Walgreen	3.1% of assets
Colgate-Palmolive	2.7% of assets
Viacom B	2.5% of assets
United Parcel Service	2.4% of assets

So within this flagship portfolio, the portfolio manager appears to have made the bold move of keeping half of past TMT losers (don't they know the word "stop loss"?), and then supplemented this ongoing bet with two new TMT exposures in Univision (currently 61.9x earnings) and Viacom (currently 29.2x earnings), plus some added "core" holdings of consumer staples stocks. But these added consumer staples stocks are all still trading at P/Es in the high-20's. Are Colgate, Walgreen, and UPS really growing that quickly to deserve such multiples?



Why are any of these stocks so compelling to Janus? Or is it just that these stocks haven't happened to go down yet, so they appear to be a relative "safe haven" to these uncreative Janus minds?

Meanwhile, in some of the other Janus portfolios such as **Janus Growth and Income Fund**, we find that an increased number of financial stocks have made their way into the top 10 list.

<u>Janus Growth and Income Fund, selected top 10 holdings as of 3/31/04:</u>

Citigroup (4.4% of assets);
Tyco International (4.3% of assets);
US Bancorp (2.3% of assets)
Fannie Mae (2.2% of assets).

Perhaps the worst mix we spy is within **Janus Adviser U.S Value Investment Fund** where the manager has deemed an 84% weighting into financial stocks to be the prudent path. Some of the top holdings here include:

Fannie Mae (8.9% of assets);
Freddie Mac (8.8% of assets);
AIG (7.8% of assets);
Cincinnati Financial (6.8% of assets);
State Street (4.4% of assets);
Wells Fargo (4% of assets).

These exposures are on top of a 15.9% exposure to Berkshire Hathaway that is perhaps forgivable, but still includes a significant exposure to the re-insurance business. Let's hope the 2004 hurricane season isn't a bad one for holders of this portfolio.

As a whole, Janus has largely kept its bet on TMT and simply supplemented it with added consumer cyclicals and financial stocks. Hardly any energy stock (save Exxon in one portfolio) or a gold stock can be found anywhere in their line-ups. We think that Janus is largely asking for even more trouble with their new portfolio approach.

The firm has also just agreed to spend $29 million over three years to hire a new CEO, Gary D. Black, arriving from Goldman Sachs Asset Management, to try to salvage their sinking ship. But if the basic mindset of the Janus investment portfolios has not changed, and these portfolios still lack any sign of true investment creativity, is there any real hope for this firm? Is not Janus still living in the buy-and-hold big-cap tech era of the 1990's, when a whole new approach of more nimble and active portfolio management is now required?

The public has continued to vote with their feet by redeeming $7.9 billion from Janus in the last three months of 2003, and an additional $5 billion through February 2004. The company itself expects that another $4.5 billion will leave the firm by May. These are particularly nasty numbers when one considers that during February 2004, equity mutual fund inflows into the industry as a whole reached positive levels approaching those of March 2000.

The cutesy ads of Janus portfolio managers climbing out of manholes clearly aren't hacking it anymore. We think the stock of Janus is still headed toward a Fibonacci target just below $7 a share.

Cycles of Note

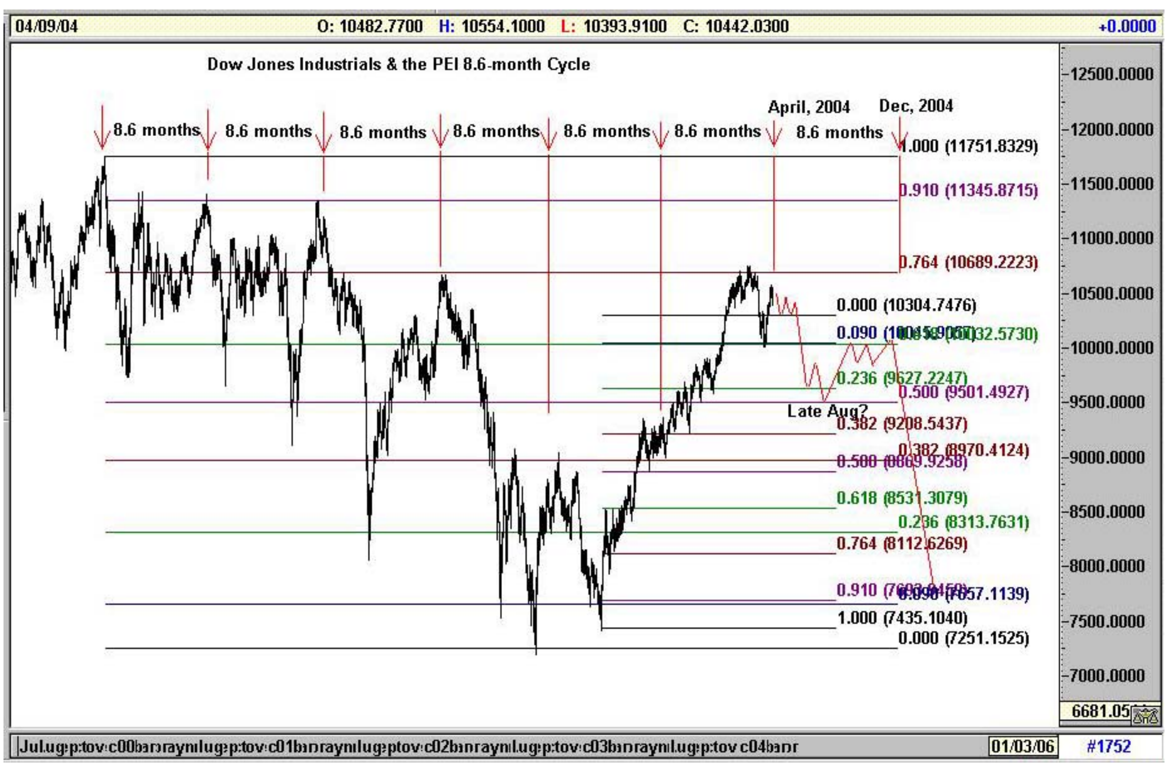
Meanwhile, we approach, of course, an intermediate PEI cycle date of April 13, 2004.

In a recent early March web-posting, we wrote that if this date were to bring a low around 1070 on the S&P, then a grind higher "hang year" for the balance of 2004 could transpire into the more important December 30-31, 2004 cycle window.

However, such a path was not to be -- equity prices having since rallied back quite substantially. We therefore believe at this time that a step and stumble decline will likely begin shortly after April 13th – a time when IRA capital flows into the equity markets will seasonally dry up. This should lead to a late August low (on our about the next 4.3-month PEI cycle of Aug. 22, 2004) that may mark the end of an Elliott Wave "wave 1 of III" decline. This may start slowly, but be a warning shot across the bow that a big-picture bear market is still alive and well.

Our preferred view is then that December 30-31, 2004 would potentially be a "2 of III" bounce, just in front of a nasty "3 of III" decline as 2005 begins.

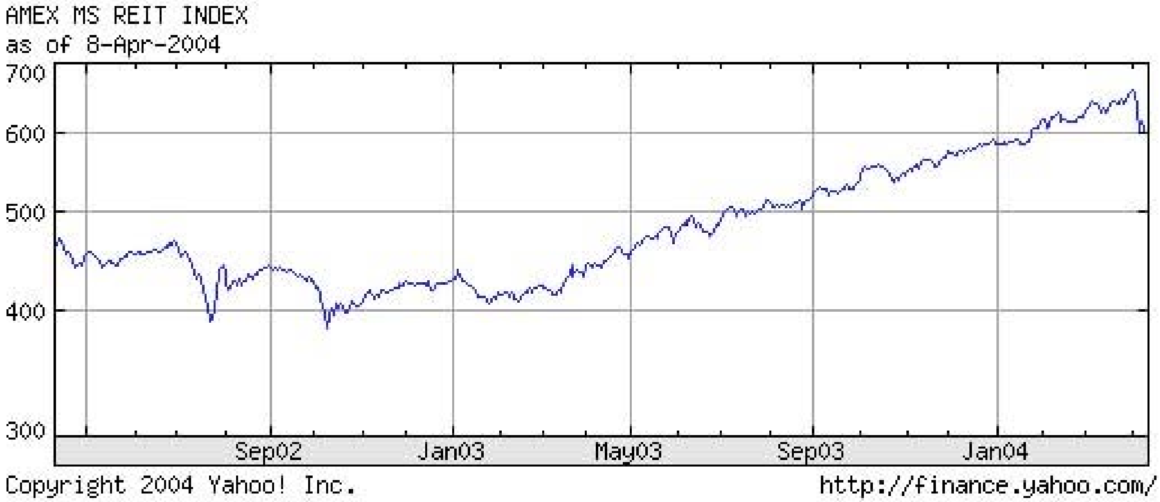
This view fits the overall PEI high-to-high 8.6-month cycle rhythm depicted below in terms of the DJIA. 2004 may still qualify as a "hang year" overall, but with a slightly different and more immediately bearish complexion than the potential path depicted in the web posting of March 12, 2004. This would, however, be largely consistent with the Paul Kasriel "1972=2004?" analog that we praised back in our March 3rd web posting. Anyone who has not read that article by Kasriel certainly should.



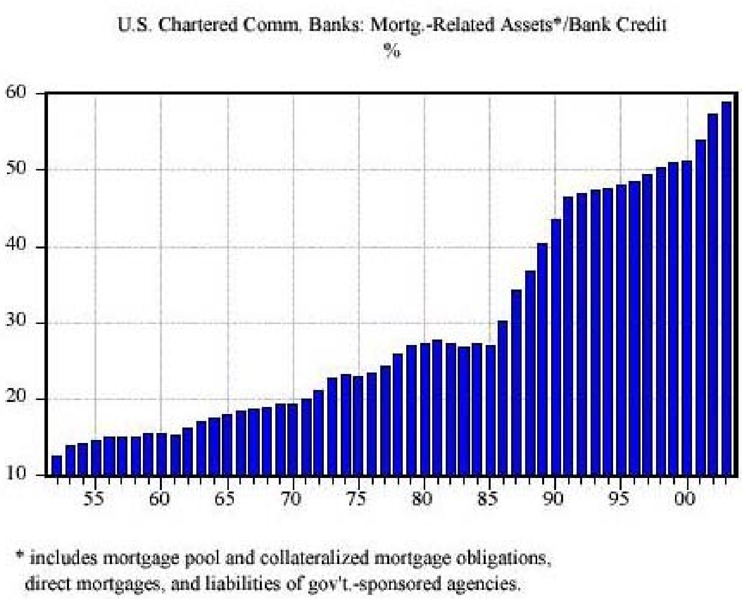
The other thing that we believe April 13th may bring – perhaps much to the chagrin of Janus portfolio managers -- is the beginning of an end to the relative strength of consumer retail stocks and financial stocks.

As shown below, when the bond market recently suffered a major decline on April 2nd, the Amex Morgan Stanley REIT Index broke a major up-trendline as well. And where the real estate market goes, financial stocks and retail stocks should soon follow. This is because both banks and consumers are currently very dependent upon the housing/mortgage market staying healthy. (See chart below from Paul Kasriel on mortgage-related security holdings as a percentage of total bank assets. It is a scary picture!).

Real Estate market breaks first…concomitant with bond market decline…



…**And because consumer spending has been tied to perceived housing wealth and refinance activity, with mortgage-related securities being at an all-time high as a percentage of total bank assets….**



Source: Northern Trust

…Retail and Banking stocks (at present, still topping) should soon follow the real estate sector lower…

Few may realize this, but many small cap stock indices such as the Russell 2000 and Value Line Arithmetic Index also recently reached new all time highs. This persistent relative strength of smaller companies (many with low balance sheet quality) should also end shortly.

Indeed, is that the infamous George Lindsay "Three Peaks & a Domed House" formation that we see developing on the Russell 2000?

Astro-financial analyst Arch Crawford has previously anticipated the April 2004 period in terms of astro alignments with the following words: "explosive, vicious, brutal, depressive." So far, recent event in Iraq fit this description pretty well, albeit the U.S. equity market has appeared more resilient than anyone might reasonably have expected within such a geo-political environment.

For the upcoming days of April 23-24, Crawford predicts: "More attacks, by U.S. or against the U.S! This entire period is fraught with tension and danger, especially chemical/biological attacks. On May 7th, Mars enters the USA sign of Cancer, crossing the point of the pre-911 Eclipse of June 2001. This will no doubt stir up strong revolutionary emotions and precipitate more military action."

Yet despite all of this nearby negativity, Crawford's Mars/Uranus cycle window for an equity market crash event does not begin until August 18th and extends through March 2005.

We also know that Saturn will remain in Cancer until July 2005. Last June, we wrote the following about Saturn in Cancer periods:

> Saturn in Cancer periods have in the past typically come at *the end of difficult period*s -- the last days of WW1 (from May 11, 1915 to June 24, 1917 - with the exception of a short 6-week interlude in the 4th quarter of 1916), the end of WW2 (June 20, 1944 to August 2, 1946), and the end of the Vietnam War and Watergate (August 1, 1973 to Sept 17, 1975).
>
> Basically, the sign of Cancer is associated with the home and with endings, and Saturn with difficulties and limitations. The U.S. is also a Cancer country, being founded on the 4th of July 1776. Thus, Saturn in Cancer periods often bring fear or difficulty with the home (property markets) and to the U.S. With President George Bush also holding a July Cancer birthday, Saturn in his sign may prove further constricting and frustrating to him personally.

We specifically thought at that time that Saturn in Cancer would bring immediate duress to President Bush and to equity markets. Instead we got a spurt of duress in June-July 2003 to Freddie Mac, Fannie Mae and the U.S. fixed income market -- with the U.S. bond market experiencing its largest 1-month decline in over 20 years. Despite clearly missing the mark on equities, we were actually just two weeks early in calling for a significant bond market decline when we penned our May 26, 2003 article entitled *Debt Bubbles & Islamic Threats*.

This spring season appears to be starting off in a somewhat similar manner. The U.S. bond market dropped a swift 3 points on April 2, 2004 in reaction to stronger than expected Non-Farm Payrolls release. The chart pattern below of bond yields currently points towards a rise in 30-year yields toward a 5.68-5.76% Fibonacci target region. This chart has the same lines drawn on it as we have posted previously.

All of this would appear to be setting up for a 1987-type of environment where "metals rally and bonds fall until stocks eventually drop," with an equity market crash risk increasing over time. The difference between 1987 and now however is that the U.S. economy is far more sensitive to interest rates going up than it was back in the late 1980's. There is also less firepower in Mr. Greenspan's arsenal to fight bond or equity market misbehavior.

We would thus not be surprised to see bond weakness beget equity and financial stock weakness <u>far faster than it did back in 1987 – perhaps concomitantly instead of sequentially.</u>

Sketching an exact path for equities remains tricky, but a step and stumble lower beyond April 13th, followed by an acceleration lower post December 30-31, 2004, certainly seems a reasonable path to expect. The path depicted earlier in this article for the Dow Jones may leave 2004 as something of a modestly negative "hang year," but be setting-up for a simply atrocious 2005-2006.

In terms of the currency markets, we mentioned in our January letter that certain cycle analysts were anticipating a dollar low in mid-February. One of these was John Taylor, currency cycle aficionado at asset management firm FX Concepts (with $9 billion under management).

Taylor now believes that general dollar strength will last into at least late May, but possibly all the way to early August. The catalyst for this temporary dollar strength would appear to emanate from the increase in long term rates within the U.S. and the relative turmoil in European politics (note the Spanish and French elections of late).

Overall, the implication in the short term may be for lower bonds, higher dollar, yet stumbling stocks – a slightly odd combination, but a notably different combination from late 2003's general thematic of higher bonds, lower dollar, and higher stocks.

But longer-term, Taylor then sees dollar weakness resuming in a big way, and lasting all the way until a March 2006 major cycle low for the dollar.

Why March 2006? Taylor has his own techniques not fully revealed to us, but among them, he mentions a 35-year cycle between economic crises: "Nixon took the U.S. off the gold standard in 1971, so 35 years later something of equal magnitude should happen – something in the economic system should break." 35-years prior to 1971 was 1936 – a year that saw the first publication of Keynes' *General Theory of Employment, Interest and Money,* and geopolitical tensions mounting as Europe moved towards World War II. 35 years prior to this was 1901 – a year that saw the death of Queen Victoria of England and the end of an era when Kings and Queens ruled the European political landscape -- with the overthrow of the Russian aristocracy to follow in 1905. Indeed, by the spring of 1901, the British Empire was already starting to show serious cracks when a proposed commercial alliance with Germany suddenly fizzled out. Another 35-years earlier, in a debt-laden post-Civil War America, one finds the Funding Act that provided for the conversion of U.S. short-term securities into long-term bonds.

In other word, 2006 should be a period when promises get broken -- past norms changed – a day of reckoning for debt-laden America finally reached. In comparison to Taylor's call for a March 2006 period of stress, we actually see Jan 6, 2006 as a double 2*pi*1000 from the August 15, 1971 Nixon gold window closure. We also show a June 6, 2006 PEI cycle date as a period for acute stress. And if Martin Armstrong were by our side, he would surely point out that such latter date is coincidentally 6/6/06 – the sign of the devil.

Most Immediately

But enough about the long-term.

Most immediately, and as espoused on these pages in the past, we remain bearish euro-yen. As depicted on the chart below in terms of the old mark-yen relationship, 59.72-62.10 (highlighted in yellow) should beckon. In euro-yen terms, this target region is 116.80 to 121.45.

For the “legs” on this cross, we would not be surprised to see 1.17 euro and 101 yen – although other possibilities obviously exist, and our real intermediate-term technical target for usd/yen is all the way down at 95. Thus, look for dollar strength in the short term -- <u>but we would not expect such against the yen.</u>

As a second immediate trade, one might consider trolling amongst the financial longs within the Janus top ten holdings lists, and picking one or two to short.

To our eye, Freddie Mac deserves to decline to at least $45, rather than its current $60 price. The Fannie Mae price pattern (not shown) is likely equally vulnerable.

Citigroup is also a great short-sale candidate at current levels, even if on past occasions, we have been early and wrong in our bearish views on this stock.

Elsewhere, we wrote several months ago about Jim Chanos's bearish view on several stocks. So far, only Leapfrog Enterprises has reached its downside Fibonacci objective via a recent plunge lower (kudos to Jim on this one). Other stocks covered in that article may still represent good short sale candidates – particularly Blockbuster, a company consistently losing market share to the cheaper and more user-friendly web-based Netflix. To our eye, the Blockbuster chart pattern shown below certainly appears to remain vulnerable for a fall toward a sub-$10 Fibonacci downside price objective.

Conclusion and Caveat

We could of course be wrong about immediate equity weakness, and the PEI April 13th date could mark an extreme in some other market or trend. A significant vault above the recent S&P high at 1163.23 might mean a more traditional bond decline/dollar strength period -- both being driven by the temporary perception of a strong U.S. economy – results initially in further equity strength, even if such strength would be unsustainable much beyond Dec. 30-31, 2004.

We have perhaps 90% confidence that the 1163.23 high on the S&P was the *finale* for this large countertrend bear mark rally that has stretched effectively from all the way back in July 2002. But we maintain a 10% worry that an even more substantive full-blown bear-market retracement to 1260 on the S&P might still linger.

But if the Russell 2000 shortly rolls over in a Lindsay "Three Peaks & Domed House" formation together with the Value Line Arithmetic Index over the next few days and weeks, and if the Morgan Stanley Retail Index and S&P Bank Stock Index both leave a clear top as well -- watch out below. Equity weakness that begins this April may take until next January to truly accelerate lower, but a second round of Janus missteps in retail and financial stocks certainly looms.

Send us your comments at information@Sandspring.com.

AN IMPORTANT DISCLOSURE

Sand Spring Advisors provides information and analysis from sources and using methods it believes reliable, but cannot accept responsibility for any trading losses that may be incurred as a result of our analysis. Our advice should be deemed our personal opinion and not a recommendation to invest. Individuals should consult with their broker and personal financial advisors before engaging in any trading activities, and should always trade at a position size level well within their financial condition. Principals of Sand Spring Advisors may carry positions in securities or futures discussed, but as a matter of policy we will always disclose this fact if it is indeed the case. Under normal circumstances, we will also specifically not trade in any described security or futures for a period 5 business days prior to or subsequent to a commentary being released on a given security or futures contract. Principals of Sand Spring Advisors currently hold positions linked to major equity indices that will benefit from an equity market decline.