Steve Sjuggerud's TRUE WEALTH

February 2004

Don't Lose Money • Get in Early • Take the Government to the Cleaners • Landlords Don't Go Broke

How to Get a 30% Discount on an Investment That Pays Better than the Stockmarket

And Collect a 6% Dividend Along the Way!

Smelling opportunity, Leon Levy bought a huge stake in a railroad company, Milwaukee Road, in the late 1970s.

Leon then took a trip to Milwaukee, and asked the company accountants what they thought the railroad and its stock were worth. *"The answer came back promptly and unequivocally: zero,"* Levy said.

The answer wasn't a shock to Levy. Milwaukee Road had just gone bankrupt… for the third time. The railroad was *"losing $500,000 a day and had many thousands of miles of unprofitable and dilapidated track."*

However, Levy knew that Milwaukee Road was a "land-grant" railroad – meaning that they were given *millions of acres* of land adjoining the railroad by the government.

INSIDE THIS MONTH'S TRUE WEALTH

- **High Risk Bonds - Are They Worth the Risk?**
- **Homebuilders…I love 'em all…**
- **The No Brainer Dollar Play**
- **Are The Preferreds Charging a Premium?**

Long story short, six years later, Levy sold shares in this business, which he basically got for nothing, for $150 a share.

This month's recommendation is not a railroad. But the reasoning behind the recommendation is the same that Levy used to buy Milwaukee Road. When I see it, I see billions of dollars of extremely valuable assets.

Levy sums up what he saw… *"Management executives looked to the past in their assessment of the railroad. They saw its wretched history of bankruptcy and losses, the thousands of miles of useless track, and the years of failed attempts at regulatory reform; from this they could only conclude that Milwaukee Road was a failed railroad that could never be profitable.* ***We looked at the same railroad and instead saw vast assets in real estate and machinery that could be sold."***

We have an extraordinary opportunity this month. We can purchase vast, productive assets in real estate and machinery at a 30% discount to their liquidation value, just like Levy did. We'll make large profits as this discount evaporates and we'll get paid a dividend of 6% a year while we wait. It's an incredible opportunity. Let me show you…

JUST THE WAY I LIKE IT

A hated business, in an uptrend, offering great value

Until I met my father-in-law, I didn't know you could get a degree in Paper Science. But his father told him *"Son, people are always gonna need paper,"* so off to N.C. State he went to learn about paper.

It turns out that making paper is a complicated, dangerous, and capital-intensive business. Worse, it's not a very good business to be in… My father-in-law has been in the business for nearly all of his adult life. In the entire time I've known him, the business has been shrinking. While his dad was right that people will need paper, his dad didn't count on the internet, or on competition from overseas.

It's bad out there in the paper biz. U.S. wood pulp production has fallen in each of the last six years, since 1998. Even worse, as the newsletter *Timber Trends* says, there's a "*fundamental change in historical trends, as paper industry production has not matched overall growth of the economy."* As an example, the U.S. economy grew by 7.2% in the third quarter of 2003, but paper volumes were down, again.

Paper mills have been closing left and right in the Southeastern U.S.. Foreign competition has been crushing. Imports of printing/writing paper have increased by 26.5% since 1999, while U.S. output has fallen by 13%. My father-in-law has even been asked to be on the lookout for assets to dismantle and ship to China.

Folks in the business are distraught. I spoke with an accountant specializing in timberlands, and he couldn't find a single positive thing to say… He even said *"I was in Russia, and they've got a lot of trees… and they'll be on their way here someday."*

Talk about pessimism… lumber and paper from Russia competing in the Southeastern U.S.? That's years away… if ever. I see that pessimism, and I like it. The extreme pessimism will allow us to buy some extraordinary assets at a discount… just like Leon Levy did…

MY REAL REASON FOR BUYING

The real reason I ended up finding this investment is that I wanted to own some timber.

Timber is one asset that is extraordinarily cheap right now. And after a ton of research, I discovered that *the cheapest way to buy vast timberland assets at a huge discount was to buy stock in a small paper business that happens to own millions of acres of valuable timberland.*

Historically, timber has performed incredibly well. According to legendary investor Jeremy Grantham, timber prices have beaten inflation by 3.3% a year over the last century. Add in 6% a year in income (from cutting trees), and 2.5% a year in inflation, and you've got returns of nearly 12% a year in timber… that beats the return on stocks! Even better, the **returns on timber have been less volatile than the stock market**.

Right now, it seems, just about every asset is overpriced. Stocks at a P/E of 30 are way too expensive to buy. Bonds that pay 4% interest aren't exciting, and neither is 1% on cash in the bank. The price of gold and many other commodities has risen by 50% and more in recent years.

Timber is the odd man out. Timberland values actually fell in 2000, 2001, and 2002. As timber has

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been a good asset to own over the long run, the last few years have been the worst few years anyone can remember.

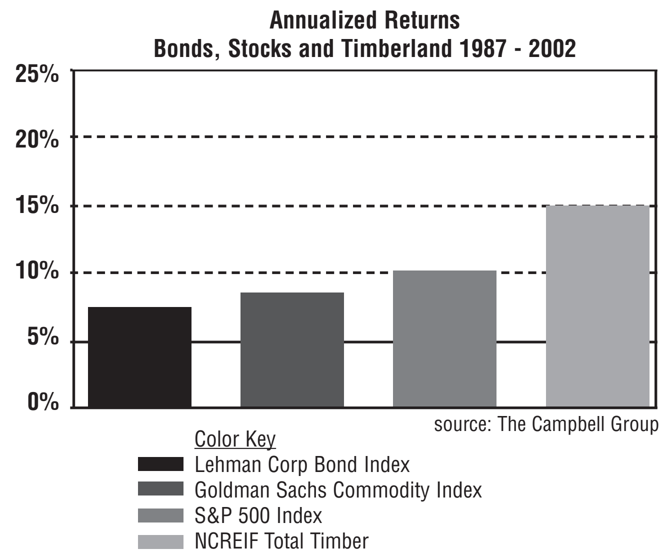
"Perfect!" I say… you see, the trees have kept growing… and gaining value… all this time. *Today we're coming off the worst stretch of timber returns in many years. Pessimism in the industry is high. But in the midst of pessimism, lumber prices have been in a strong uptrend.* **It's my recipe for success… a cheap asset, with great skepticism surrounding it… in a powerful uptrend. Time to buy!**

TIMBER PERFORMS WELL WHEN STOCKS PERFORM POORLY

The last great bear market in stocks began in the late 1960s until about 1980. An *investor in stocks during that time literally lost money*, due to inflation. However, as the table below shows, *an investor in timber never had a losing year…* More often than not, the returns were in the double-digits… with a 55% return in 1973 and a 47% return in 1977.

Year	Stocks	US Timber
1966	-10%	13%
1967	24%	11%
1968	11%	18%
1969	-8%	22%
1970	4%	1%
1971	14%	4%
1972	19%	11%
1973	-15%	55%
1974	-26%	21%
1975	37%	1%
1976	24%	16%
1977	-7%	47%
1978	7%	29%
1979	19%	31%

The 1970s weren't a timber fluke. Even in recent decades, timber has been one of the best assets to own. Consider the graph on this page... it shows a comparison of the annualized returns for timber versus several other investments. As you can see, timber has performed better than stocks, bonds and commodities. The total compounded gain during this period was about 16%.



Clearly, timber is an opportunity now. So how do we play it?

EXACTLY HOW TO BUY TIMBER, AT A 30% DISCOUNT…

The traditional way people buy timber is by buying the trees. But that's the hard way. The easy way is to get at timber through publicly traded companies. I'd rather buy company stock than trees. I'd even be willing to pay a premium to buy the stock, since I don't have to go through the rigmarole buying the land, insuring it, maintaining it, etc.

Fortunately, it's actually cheaper to buy timber through a stock right now than to buy the land with the trees. It's crazy. But it's true.

The company we're buying this month is Rayonier (NYSE:RYN). Rayonier used to be a paper company… until this year. Effective January 1, 2004, they converted into a timber REIT (real estate investment trust). Rayonier has committed to selling off 2-4% of its ***two million-plus acres*** of timberland each year, in order to provide us with a stable dividend, currently in the 6% range. In addition, the dividends from a REIT have some potential tax advantages. Lee Nutter, Chairman, President and CEO, rang the closing bell at the New York Stock Exchange January 5, 2004, to celebrate Rayonier's conversion to a real estate investment trust effective January 1.

"The Closing Bell ceremony is an excellent opportunity to "ring in" a significant new chapter in Rayonier's nearly 80-year history and commemorate our upcoming conversion to a REIT…we have been very pleased with investor reaction since the announcement of our conversion plans in August," Nutter said. "We believe the tax-efficient REIT structure will provide greater opportunities for growth and increased returns to shareholders."

Rayonier's timberland is incredibly valuable… A conservative guess is that the company owns approximately $2.7 billion dollars worth of timber.

That was timberland. But Rayonier is sitting on a gold mine of developable land in Florida as well, as Rayonier owns much of Nassau County, Florida - a booming county on the coast. Rayonier has a good deal of land that's likely on its books at $750 an acre, that it may be able to turn around and sell for $50,000 per building lot, in Nassau County. 20 years ago, this county was a road to the beach, covered in trees. Now it's growing from I-95 to the beach, and west of I-95 as well… all Rayonier lands. 10,000 homes are expected to be built in the coming years, and a Super Wal-Mart and Lowes have just opened in the last year. Demand for developable land will be huge. And Rayonier owns nearly all of it…

Not counting that extraordinary potential, Rayonier conservatively has $2.7 billion worth of timberland. When you add up the rest of their assets (again, valuing them conservatively, for example, I'm valuing their sawmills at 25 cents on the dollar), and subtract out the debts, **I come up with a liquidation value of just under $3 billion dollars.**

Rayonier Timberland	Acres (in 000s)	Value per acre	Total value
Southeast	1,700	$ 1,066	$1,812,200
Pacific Northwest	378	$ 1,918	$ 725,004
New Zealand	129	$ 1,000	$ 129,000
	2,207		$2,666,204

Amazingly, the stock is only valued at $2 billion. It is an extraordinary value.

In addition to the timber business (which is run as a separate profit center), Rayonier has a smaller paper operation. I like the fact that the timber business doesn't just "give" its timber to the paper operation as it needs it… The timber division auctions its timber to the highest bidder. Over 90% of Rayonier's timber is sold outside of Rayonier.

I believe, these values per acre are extremely conservative. The first two come from the most independent industry source available; the National Council of Real Estate Investment Fiduciaries (www.ncreif.com), and the value for the New Zealand land is just a low guess from me, since it is a small portion of Rayonier's holdings anyway.

To give you an idea of how conservative these are, consider that a week or two ago, Rayonier announced proceeds of $26 million from the sale of 5,500 acres of timberlands in Northeast Florida… nearly $5,000 an acre. And this was not even the sale of land… it was the sale of the timber rights to the land. Amazing.

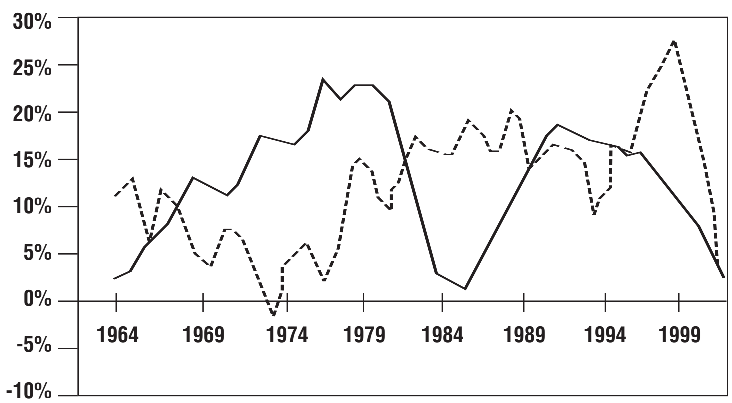
The paper operation is an outstanding business, as far as paper operations go. Most of the paper industry in general is a "commodity" type business. But Rayonier's business is "Performance Fibers" – things you wouldn't even recognize as paper… Rayonier performance fibers are in race car tires, diapers, dynamite, films, pharmaceuticals, etc.

Rayonier's performance fibers are high-tech stuff… with high-tech margins. It's hard for emerging countries to compete with this stuff… and their main competition in this segment in the U.S. recently threw in the towel. With high profit margins and market share in the business, Rayonier can comfortably call itself the world leader in **"high-value specialty pulps."** (I realize you don't lie awake at night dreaming about investing in "high-value specialty pulps", but it is a welcome contributor to our dividend in Rayonier.)

Rayonier owns $2.7 billion worth of timber. The entire business is probably worth almost $3 billion… or nearly $60 a share. The current market price of Rayonier is about $40, so I consider it a steal…

We'll collect 6% a year in dividends… our trees will get back on track of gaining in value at 3% above inflation or more… giving us a return on our investment of nearly 12%... all while we wait for the company discount to disappear, which could be as much as a 50% capital gain for us… in timber.

Rolling five year total return on the S&P 500 (dotted line) versus the rolling five-year total return on Rayonier's geographic mix of timber



Remember, trees don't care about stock market manias, or bubbles, or crashes. They just keep on growing. Time to get in while the getting is good and cheap. **Buy Rayonier today, with up to 8% of your portfolio. Use a 25% trailing stop.**

WHERE TO BE INVESTED RIGHT NOW

<u>OUR HIGH- RISK BONDS ARE NOW A SELL</u>

The "Bond Man" sells his bonds… should we? The answer is yes…

As the most successful bond fund manager in the world, Bill Gross gets paid $40+ million a year to invest in bonds for his clients. Recently, The Bond Man has moved some of his own retirement money out of his world famous bond fund and into the **Pimco Commodity RealReturn Index Fund (PCRDX).** We beat him to the punch… buying this fund two months ago, and it is still a strong buy. <u>PCRDX will likely be one of my favorite picks for the rest of this decade.</u>

Why is he moving his money out of bonds? And why are we selling a few of our bond-type investments? In short, because the returns aren't worth the risk…

When we bought high-risk bonds (both "junk" bonds and emerging market bonds, through **VWEHX, DSU**, and **MSD**), we were paid extraordinarily well for taking on the risk. Now the risks aren't worth it…

According to data in the Financial Times newspaper, both Russia and China can borrow dollars at interest rates of one percentage point above U.S. interest rates… to me that's crazy… there's a chance that Russia or China may decide not to pay us! (With Russia it happened as recently as 1998!)

I don't want to own those bonds anymore. So this month, we're selling the **Morgan Stanley Emerging Markets Debt Fund (MSD**), as well as the **Vanguard High-Yield Corporate Fund (VWEHX),** and the **Debt Strategies Fund (DSU).** <u>We're closing these out and pocketing nice total returns of … 32%, 23%, and 50% respectively.</u>

"Steve, I understand your reasoning, but I really like the income that these pay. Is there anything I can buy to replace that income?" Fortunately, there is…

VIRTUAL BANKS – BACK TO A BUY

Annaly (NLY), the larger of our two virtual banks, posted blockbuster numbers for the fourth quarter. I thought good numbers could be possible. So I wanted to wait until we had the full picture before acting.

To give you an idea, Annaly was paying a dividend of $0.60 a quarter. Then in the third quarter, due to some extraordinary circumstances that I've written about in the past (namely prepayments), that dividend was whacked in half, down to $0.28. The fourth quarter number was critical… We'd find out if the extraordinary circumstances were behind them, or not…

Annaly paid a dividend of $0.47. So the extraordinary circumstances are significantly behind them. It looks like Annaly may be able to earn a spread of 1.75 to 2.00 in 2004. In plain English, that means the double-digit dividend should stay in tact for the full year.

Buy Annaly now, and by extension, buy the smaller and similar **Anworth (ANH). I expect both to continue raising their dividends in 2004. We're looking at dividends in the 11% range.** Buy now.

Our other U.S. income plays, **LQD and FBDFX, are holds**. Simply not buys, and not sells.

OUR PROTECTION-FROM-THE-DOLLAR PLAYS

I still like these… **FAX** has been a strong performer, and should continue to perform well. It pays a nice dividend, primarily outside the U.S. dollar.

For less yield and less volatility, the **Everbank** Commodity Currency Index CD is a great way to go. It gives you a FDIC-insured CD that is denominated in Australian dollars, Canadian dollars, South African rand, and New Zealand dollars. This one is a no brainer. For details find it on www.everbank.com. The Vanguard Inflation-Indexed Fund **(VIPSX)** remains a hold.

GOLD AND GOLD COINS

The gold rally has been fun… we're up 37% on average in our gold coins… and our two gold stock plays… the Freeport Preferreds and Newmont, are up 77% and 48% respectively.

For our gold coins, they're a hold. They've run up too much. I'm willing to pay a 50% premium above the price of gold for the MS63s and a 200% premium above the price of gold for the MS65s. Beyond that, it's too expensive. And all our coins are above my buy-up-to prices right now.

For our stock plays, **it's time to sell our position in the Freeport Preferreds (FCX_pc).** The preferreds, which represent 1/10th of an ounce of gold, sell for about $43.50, and the price of gold is around $410 an ounce. When we bought these originally, we were buying gold at a $60 discount or so. Now this is like buying gold at a $25 an ounce premium. No thanks. **Newmont remains a hold.**

OUR STOCK PLAYS

EEM and EZU are still buys… it's still a bull market, according to the 1-2-3 model. And we'll own these as long as YELLOW LIGHT mode sticks around. If you haven't done so already, **sell your position in the Rydex Venture 100 Fund (RYVNX).** We hit our stop. Move along.

REAL ESTATE AND HOMEBUILDERS

This picture hasn't changed… **Our REITs are a hold (EOP, EQR, SPG, BXP), and our other property-related plays are a buy (CRESY, TAVFX, and the homebuilders).**

The REITs are simply expensive, and getting more expensive. We'll hold 'em for the ride, and sell out when/if our stops are hit. People love these dividends, so the ride may continue much higher. We'll know more about **Cresud** when we visit them in March.

The **homebuilders (DHI, BZH, and SPF)** are still a great buy. Yes, we're up 119%, 37%, and 39% respectively. But they're still very cheap. I love 'em all. **Buy 'em if you don't own 'em yet.**

In case you missed it, I reminded you in a mid-January True Wealth Tuesday email why these are still my favorite stock buys in the market…

"Sticking with the big picture, we've got what I love to see… a hated business, that's cheap, and growing like a weed. The reasons to like homebuilders are too numerous to list. Here are a few…

-THE SUPPLY AND DEMAND DYNAMIC RIGHT NOW IS RIDICULOUS. The supply of new homes is at generation lows, meanwhile demographic trends suggest unrelenting demand and low mortgage rates will let that demand be satiated.

-CONSOLIDATION. This isn't just a buzzword. It's happening. The top ten builders accounted for roughly 10% of the market 10 years ago. Now they account for 20% of the market. In hard times, they'll be able to garner more market share, buying up overextended local builders.

-ECONOMIES OF SCALE. The big builders have an almost infinite access to cheap capital if they need it, giving them the ability to crush local builders money wise. They can also crush them cost wise as they negotiate nationwide materials contracts. Lastly, the big, diversified builders can wait out the permitting process for years without worry, while a local builder may be seriously strained waiting with all his cash on the line.

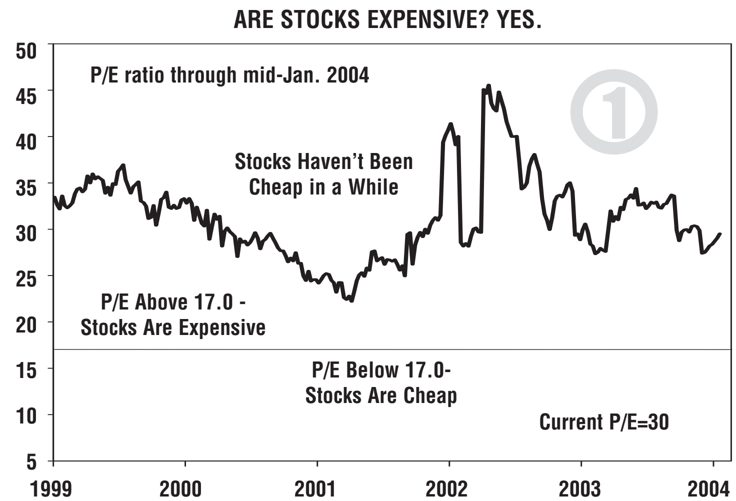
-THEY'RE SUPER-CHEAP. They're giving these stocks away… The forward P/E ratios for our recommended homebuilders are in the single digits. It's crazy.

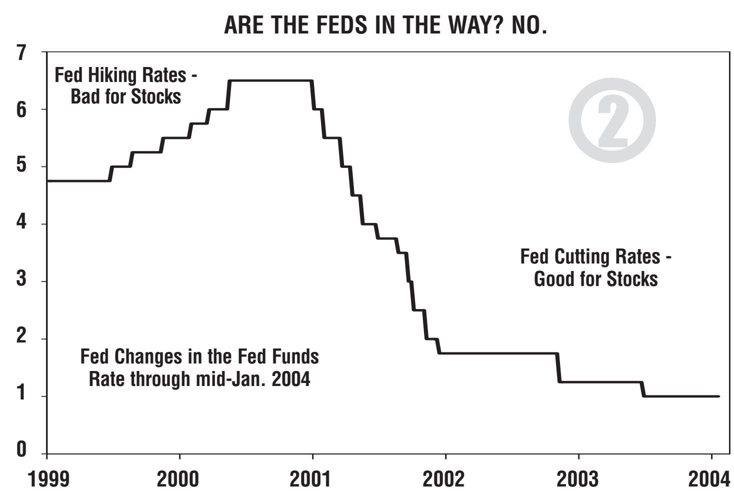
It's obvious I like 'em. I think they'll be great stocks to own for a long time, with the potential for a double from here.

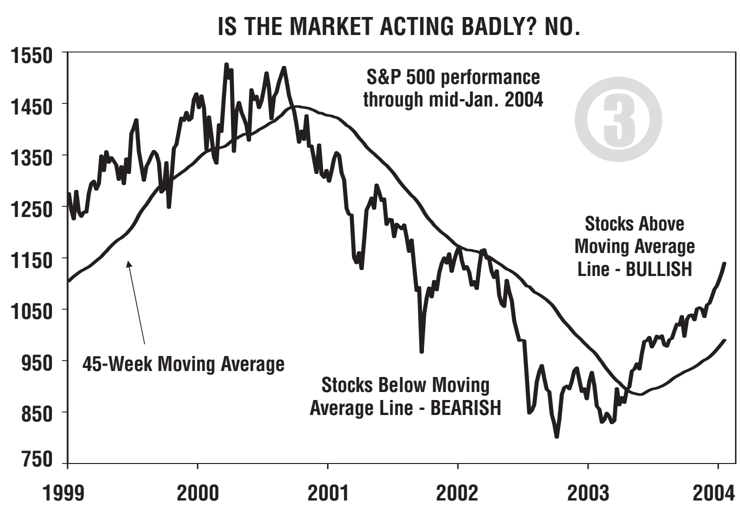
U.S. 1-2-3 STOCK MARKET MODEL: BUY AND HOLD

One out of three questions is against us... that's YELLOW LIGHT MODE -- Buy and Hold

Stocks make 10.7% per year in YELLOW LIGHT MODE







However, if we hit our trailing stop, I WILL RECOMMEND SELLING."

So, you've got lots to do this month… clean out your high-risk income plays and use those proceeds to buy our virtual banks… Buy the homebuilders if you don't own them yet (and buy them again if you sold)...

And lastly, buy Rayonier. A fun month!

Good investing,

Steve Sjuggerud

*Investment Result: As readers found out for the next few years, you can make a ton of money in trees. Exiting Rayonier in mid-2006, *True Wealth* scored a gain of over 60% in just over two years with this timber giant.