All About the Dollar

The bigger picture for clearer decisions. John Lekas runs the Leader Short-Term Bond Fund with a top-down approach, a macro view which determines the direction of the portfolio. Opportunistic in nature, the fund aims to buy at the right moment and the right price.

Q: ***How would you describe the investment philosophy of your fund?***

A: It's a top-down approach, using the macro view of the markets to decide on the outlook,and direction interest rates are taking their direction, and the forces moving them, are our overall guiding light This doesn't mean that we wouldn't buy certain bonds for company specific reasons.

This fund launched in July 2005 to get distribution on a more wide-scale basis, as we were making money both in declining and rising interest rate environments. Our view was that the yield curve would invert and that the sweet spot over the next two and a half years would be the short end of the curve. We still believe that.

We are very opportunistic, keeping a lot of cash to take advantage of pricing. Usually, one or two industries a year tumble, whether it is Qwest, Xerox or General Motors, and it's during these time periods that we have successfully provided high Alpha.

Q: ***Would you explain your current macro view in more detail?***

A: We believe that interest rates will go up to 6% by the end of the year, the Fed is all about the dollar, regardless of their recent comments. If the Fed takes its foot off the gas for one second, the dollar will fall, oil will go to $80-$90, and commodity prices will go through the roof, resulting in a recession. The other choice is measured, tightening, and to keep raising interest rates until the dollar firms up. This is bad news for consumer because of mortgages, higher credit expenses, etc.

The theory behind this view is that when you raise interest rates, foreigners buy your currency to get that rate, thus moving the dollar up. That's going to be critical for the next couple of years, with a fairly big impact on what we do. For example, a similar low-duration fund predicted that the Fed would stop at 3.25% to 3.50% last year. As a result, they extended maturities which hurt their performance when rates kept moving up without them.

Q: ***You mentioned the inverted yield. Why do you believe that it will persist for one or two years? And why do you believe that the Fed is all about the dollar?***

Leader Capital Short-Term Bond

Fund Facts

Symbol	LCCMX
Website	www.leadercapital.com
Address	121 SW Morrison Street Suite 425 Portland, OR 97204
Tel. No.	800-711-9164
Inception	5/11/2005

Portfolio

Total Net Assets *	$ 15
Number of holdings (9/30/2006)	40
Average Duration	1.69
Average Current Yield	5.612
Turnover Ratio	N/A

Investment Information

New Investment	Open
Min Initial Investment	$ 2,500
Min Subsequent Investment	$ 100
Min Initial IRA Investment	$ 2,500

Risk (Against S&P 500 - Since Inception)

Alpha	N/A
Beta	N/A
R-Squared	N/A
Ann Std Deviation	N/A
Sharpe Ratio	N/A

Returns vs. Lehman Brothers 1-3 Gv/Cred TR IX

	LCCMX	Index
3 Mo. (Cum.)	3.01 %	2.07 %
1 Year (Cum.)	6.82 %	3.90 %

Returns vs. Lehman Brothers US Corp HY TR IX

	LCCMX	Index
3 Mo. (Cum.)	3.01 %	4.07 %
6 Mo. (Cum.)	6.82 %	8.07 %

Fees and Expenses

Max Sales Charge - Front **	3.50 %
Max Sales Charge - Deferred	N/A
Max Redemption Fee	N/A
Total Expense Ratio	1.65 %

Portfolio Manager

John Lekas	5/11/2005

** millions*
*** for amount invested less than $100,000*

Data through: 9/30/2006

Source: Company Documents; Lipper

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A: It will persist, it's the hangover after the big party. When Greenspan lowered interest rates from 6.5% to 1% in the face of the market collapse in 2000, he was trying to stimulate the economy. He knew the dollar would fall because when you take rates down to 1%, investors retreat. We did lose investors as big institutions started buying paper everywhere but here.

The correlation between the dollar and interest rates is significant and Greenspan was aware of this. But I believe that his bet was on growing the GDP through exports. Theoretically, if the dollar falls 50%, more of our products sell overseas, but that didn't happen and we have record trade deficits. The current earnings are contributing to the GDP, just not enough.

So, rates moved up about 15 times and he's only moved the dollar up probably 8 to 9%. When he moved rates from 6.5% to 1%, he brought the dollar down 50%. Getting the dollar back to its previous levels requires a move of 100%. The Fed has to get that dollar back up.

Otherwise consumer will choke on high commodity prices, as we continue to import way beyond our means.

That's why we believe that they'll continue to raise rates. Historically, recession occurs when we go inverted on the curve because costs are rising quicker than growth rates. Wages are on a flat-to-negative trend, down from $50 an hour to $25 an hour. If you don't believe that, ask the folks at GM or the airline pilots or workers in manufacturing. The only reason the feds would pause is due to the dollar stabilizing.

Currently the market is dealing with a weak dollar, due to rumors that the Fed would quit raising rates, this puts more pressure on the Fed to continue to raise rates. So our view is cemented; it's almost a no-brainer. The Fed gave up a lot of ground for no reason and if they were paying attention to what happened in Katrina, they'd know that those kinds of comments can be very dangerous. That makes you almost appreciate Alan Greenspan as he was better at information dissemination.

Q: ***I believe that the last time we had a trade surplus was in the first quarter of 1964. One could make an argument that the trade deficit is not something new and the difference is only in the magnitude.***

A: Exactly. You could also ask when was the last time consumer debt was over 80% or 90% of their assets. A guy making $100,000 a year, owns a house for $1 million and a car for $150,000. He's always in debt, as has been the case for a long time, but the intensity is greater now. In my opinion, that has to do with the falling dollar, the rising prices of houses and other hard assets, as well as with inflation.

I see all the numbers on inflation less housing and food, but I spend a lot of my income on housing and food, so I don't know how you could take that out. My point is that the falling dollar has escalated hard assets to a fairly extreme level. Going forward, I don't think that the consumer can handle much more debt because he's tapped out. So prices should start to fall i.e. recession.

You could raise interest rates on the short end and exacerbate that problem for the consumer. He can only move that credit card up to a point, so he'll cuts back either because of continued escalation in prices or because you raise rates. Both ways it's going to create a slowdown and the inversion in the curve quantitatively tells you that.

But there's always a lag effect of the Fed's action. For example, there was a 12-13 month lag between the time Greenspan started lowering interest rates and the time when the dollar began to fall. When he started to raise rates again, there's a lag of about 14 months before the dollar started to take hold. I think that we're still getting some of the benefits of Greenspan going from 6.5% to 1%.

Q: ***But we haven't been able to increase the share of manufacturing in the economy since 1975. All that we've done is creating more Wal-Marts and low-paying jobs. And we've never created more than 2 million jobs a year since 1971, while the population has been growing, and that means higher level of employment at low pay.***

A: Exactly, we've got to become more competitive. We cannot let our manufacturing go to zero. Unfortunately we let Things get to extreme points before turning them around. That will take some time, which is why the short end of the curve will persist and will be the sweet spot of the market. The other choice is inflation, which is insidious and very difficult to get rid of.

Q: ***How this macro view translates into an investment strategy and process?***

A: We have about 75% of our assets in duration under a year and we see no reason to extend maturities as we believe that the Fed will continue to rise. As the Fed raises rates, the market will come into some tough sledding and will end up down 15% to 20% at some point by December.

And there will be some opportunities in the high yield market, which is about 20% of our portfolio. We've taken

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advantage of Ford, GM, GMAC, and Ford Credit; we bought those positions in December. These are the only high-yield bonds that we have in the portfolio; the rest is in paper within a year.

That is related to our risk/ reward philosophy, which is if we can't get paid, why should we extend maturities. If we can't get paid for a credit, we're not buying it. For example, you can get 7% on American Airlines through 2012, which, a triple C piece of paper. That's not enough. I bought the same piece of paper during Katrina and got 17%. There are many examples of below investment grade paper for 5% to 5.5%, you're just not getting paid for the risk.

In the high-yield market we find some great value and we control risk by buying it right. For example, in foreign positions we can really add significant value. It's about patience, and being opportunistic in the sense that price is very important to us. GM's bankrupt would mean 60-65 cents on the dollar across the board and if you're in at 67, you control your risk. We bought this paper at 67 during the tax loss selling in December and that's opportunistically added value.

Normally, there aren't opportunities in high yield in the first two or three downgrades, as There's more to come because once you knock the companies below investment grade, then it costs them more to borrow, becoming a vicious cycle. So we were always patient.

Q: ***Would you give us some specific examples that highlight your investing process?***

A: Our investing process is simple; we look at sales and operating cash flow. A company in trouble like GM would be a good example. They are on the border line, cutting prices to keep their sales up so that they can keep their market share. On the short end, we're comfortable buying some of that paper because they have enough cash to pay their bills and their sales are adequate. So GM sales are up, they've got a lot of cash in the bank, tremendous cash flow, plus a lot of assets they can sell.

Unfortunately, I don't know if that's sustainable, as they can't keep cutting prices. GM may be doing well overseas, but 85% of their market is in North America. Part of GM's problem is they diversified into lending and finance. Diversification has been a real distraction; they need to concentrate on one or the other. Going forward, the challenge will be if they can get their finances in order and sustain sales over the long term. That's why we're keeping it really short but we're getting 12% to 17% on that paper with duration of less than three years.

> "The Fed has a real problem with the dollar. We can talk about the CPI, the PPI, and the GDP, but the reality is that if they don't keep raising interest rates, the inflation stemming from record deficits will far exceed any productivity."

about **John Lekas**

John Lekas is President, CEO of Leader Capital Corp. and Senior Portfolio Manager of the Leader Short Term Bond Fund. In 1986 Mr. Lekas began his career at A.G. Edwards & Sons, where he developed financial planning techniques. Then in 1989 he went to Paine Webber and continued raising assets. He left Paine Webber in 1991 to work for Smith Barney in hopes of entering their Portfolio Management Program. In 1993, he began the Portfolio Management.

Program. In 1997 he started Leader Capital Corp, a Registered Investment Advisory and Broker-Dealer. Mr. Lekas has over 18 years of investment experience and has managed fixed income securities on a discretionary basis for over 15 years.

Q: ***How do you approach portfolio construction?***

A: Our portfolio construct is built on our macro view on interest rates. Obviously, we gravitate to the short end of the curve and duration of under a year because we're not getting paid to extend maturities and because we think rates are going higher. So the portfolio construction depends to a large degree on the macro view and the risk/reward.

Q: ***Would you explain your research process? How do you come up with your macro view and the potential candidates for the portfolio?***

A: I do all of my own research. I've farmed it out in the past but I'm not satisfied with that. I don't want it second-hand and I don't want opinions. I want the facts filtered away from all the noise that's out there. We've boiled it down to the point that's its all about the dollar and once you get to that point, then your thinking gets clear and decisions are focused.

We use quantitative analysis too, so we do look at the underlying equities to make our decisions. For example GM at $22 on the equity doesn't look like a bankrupt situation in the near term. That can evaporate in a hurry, but it's been pretty solid. So we do look at the underlying equities, the technicials, the trending indicators, the oscillators. ■

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