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Dennis Slothower's
STEALTHSTOCKS

They don't make headlines, they just make money

July 2002

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Dear Friend,

Stocks are testing their September lows. The market is grossly oversold but the constant slide in the dollar continues to undermine the stock market. Defensive sectors are back in style but nearly all sectors are struggling. Meanwhile, the economy continues to expand. This disengagement won't last much longer, but investors need to see a marked improvement in "real earnings."

Hopefully reform is coming soon.

THE VIEW FROM MY SEAT

Growing Economy…Falling Stock Market…Crisis in the Boardroom… Steps to Rebuild Trust Underway… Out of the Ashes… The Market Will Tell Us… REITS Providing Leadership

Some time ago I sent you a report titled "How to make a fortune during the rebound of 2002." In the report, I reasoned that all economic contractions end and this bear market would also end, when "investors begin to perceive the economy is about to expand again." Does it still hold true today? I still think it does. Let's take a bird's eye view of the stock market and the economy to gain some perspective as to what is going on.

First, the economy. To sum it up, the economy is expanding. The first quarter GDP numbers were reported at +5.6%. I believe Fed Chairman Greenspan when he says the GDP numbers are expected to slow in the second quarter. However, my inside sources tell me that we will still produce a healthy +4.0% growth rate in the second quarter despite what the Fed is saying.

I see the Fed pumping up the money supply, which tells me that we should see the expansion continue. Experts are now forecasting growth to be +4.2% in the third quarter and +5.2% in the fourth quarter. Let's see + 4.2% growth in the third quarter and 5.2% growth in the fourth quarter. I may not be an accountant, but if this is not expansionary, then what is?

please turn…

Yes, I know, the bear market is very much alive. We have been stopped out of most of our stock positions and I haven't seen justification to reenter the market yet. I now want to remain defensive until I begin to see the technical underpinnings of the market improve sufficiently to sustain a positive up trend. With confidence in the dollar dropping daily, I just don't see evidence of a turnaround, at least not yet.

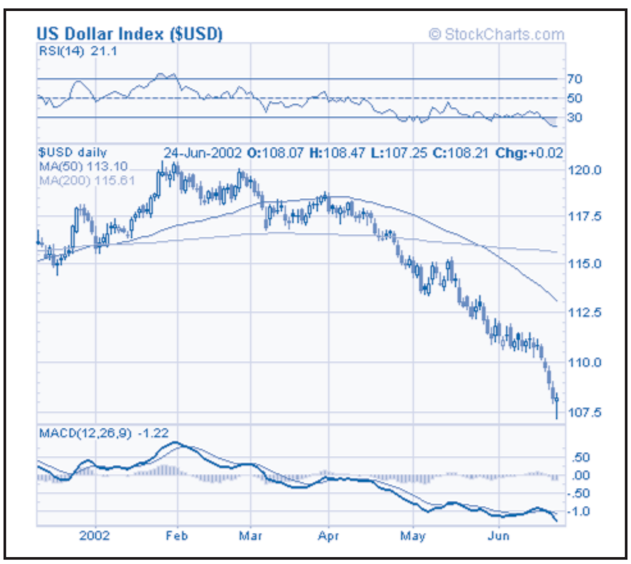
This has truly been a frustrating market. Watching the S&P 500 index fall in 11 out of the last 13 weeks and threatening to break down through the September lows makes me shake my head in wonder. The S&P 500 is fast approaching (and might even have taken it out by the time you get this) the 9/11 low.

Furthermore, unlike earlier in the year, selling is now more uniform with the advance decline line for both the NYSE and the OTC steadily eroding. My analysis shows that the vast majority of stocks are trending downward, well below their 50-day and 200-day moving averages. What is going on here?

I have been taught that the stock market leads the economy by about two quarters. Yet you have to ask yourself who is telling the truth, the stock market or the economic numbers? The stock market seems to be saying that it expects to see the economy worsen, but the economic numbers show that the economy is very much on track to do what it always does when it comes out of a recession—expand. If you want evidence, just look at the ISM manufacturing and non-manufacturing indexes, which are expanding very impressively.

Even more puzzling is the fact the Fed is doing what it should be doing—increasing the money supply. Historically, the money supply expands in order to meet the needs of a growing economy. My experience has taught me that when we see the money supply expanding, the stock market rises, but we aren't seeing that yet. Institutions are still shying away from the stock market. Why are we not seeing the big boys stepping in like they always have done in the past?

US dollar very oversold-rebound likely



A simple answer could be the fall of the U.S. dollar. But even that answer leaves me wanting. The economy is expanding and the Fed is expanding the money supply, so why isn't the dollar advancing? Certainly it is oversold enough. I think the reason why the stock market and the dollar are both falling is that investors remain confused as to what the "true" earnings picture is saying. They lack a key ingredient that makes all financial markets work, which is confidence.

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Crisis in the Boardroom

Over the last few months, confidence in corporate America has been shattered as a result of corporate earnings corruption. Investors don't know what to believe anymore and are very confused about how to determine what a company's true earnings are. They are disillusioned by all the fraud and misleading profit figures put out by companies such as Enron, Tyco, Global Crossing, Adelphia Communications, and now Worldcom.

Almost daily, there are fresh reports of large profit write-downs at major corporations. Investors are skeptical of even some of the "blue chip" companies like IBM, Microsoft, and General Electric.

A confidence crisis has gripped the market, and seeing trusted names like Merrill Lynch and Arthur Andersen being accused of mistrust and fraud has investors at the point of not knowing who or what to believe. They fear that this may be just the tip of the iceberg.

Consider the story of a man who was interviewing candidates for a job position. The first person he interviewed was a mathematician, who he asked a very simple question, "What is two plus two?" The man answered "Four." The second person he interviewed happened to be a lawyer and when asked what the sum of two plus two would be, the lawyer said, "Well, that depends on what two is." The third person the man interviewed turned out to be an accountant, and when asked the same question, the accountant responded, "What do you want it to be?"

The sad part of this joke is the truth of it. Arthur Andersen has been convicted of allowing unscrupulous corporate management to dictate what corporate earnings will be in exchange for millions of dollars in consultant fees. The very fabric of trust has been breached. Once trust has been betrayed it is not easy to rebuild. Corporate America now has to take whatever steps are necessary to restore confidence in the numbers it reports.

Steps to Rebuild Trust Underway

The public is demanding that corporations alter their nonstandard methods of calculating profits called "pro forma earnings," which have been used to hide factors that negatively affect earnings. No longer will companies be able to bury in footnotes stock options compensation to employees in order to hide corporate expenses. Many people are demanding that corporations deduct stock options from reported earnings, and it is possible that Congress or the SEC will make this a requirement.

On May 14, Standard and Poor's announced sweeping changes in the way it calculates earnings, such as including the value of stock options as well as reporting gains on company pension plans that have often been artificially jacked-up to make earnings look favorable, misleading investors.

According to Standard and Poor's, this new measure of calculating true profits or "core earnings" would have shaved close to $1 billion off of General Electric's reported profits in both 2000 and 2001.

The Enron and Arthur Andersen fiasco has also set in motion a significant amount of new legislation. Both houses of government have proposed sweeping changes, and the SEC is proposing a new "Public Company Accounting Oversight Board," which would have the authority to establish auditing and ethics rules.

This board would be able to discipline auditors and would replace the current system in which the industry largely polices itself. At least six of its nine members would come from outside the accounting industry. The board, governed by the SEC, would operate in consultation with the Treasury Department and the Federal Reserve.

A Senate bill, which passed the Senate Banking Committee on a 17-4 vote, would restrict a much wider range of consulting and other non-auditing services that accounting firms can provide to their audit clients, including bookkeeping, financial systems design, human resources services, and legal services. Accountants would be allowed to provide tax services only if the company's audit committee gave its approval. The Senate bill also would require the SEC to impose new rules on financial analysts to prevent conflicts of interest.

Interpreting earnings and calculating appropriate values for stocks is now a laborious challenge. Until safeguards for this process are in place, the true value of the stock market will be continually called into question. I believe institutions have been holding back buying (despite improving economic conditions) until they can get a firm grip on what corporations will report after they have cleaned up their messes. This may well explain why the stock market and the U.S. seem to be disconnected—for the moment—from the economy. But this situation will not last forever.

Out of the Ashes, a Bull

It has been said that out of evil, good often emerges. If corporations begin to come clean with investors, then certainly this is a step in the right direction. It may take another three to four months before investors can trust corporate earnings again, but out of these ashes will rise a far better, stronger, healthier market.

We have had difficult markets (world wars, depressions, recessions, etc.) before, and without exception the stock market has always bounced back. This country is the strongest economic power in the world, and even though it is besieged by a war against terrorists, it will conquer this evil.

Earnings may be a bit difficult to ascertain right now, but the economic recovery is very much on track. Earnings will improve, and while it may be another month or two, or perhaps longer, for earnings to be recognized by the market—make no mistake about it, the market will recognize positive growth in time.

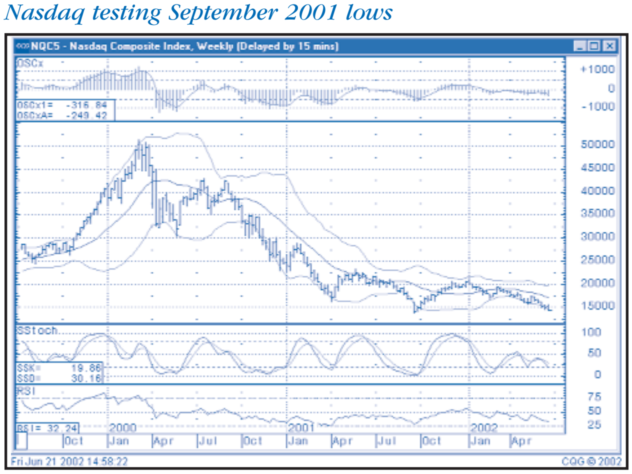
The stock market's discounting process will have to run its course but I don't believe the "powers that be" will let the market crash right before the elections. That is not how the game is played. What you need to do is get yourself ready to take advantage of some terrific buying opportunities when the market finishes its discounting. That day is getting very close now, but it is not here yet. I never want to break my first rule of investing.

The Market Will Tell Us

My first rule of investing is, "limit your losses." We live in times where risk management is a crucial part of investing. It is just as important as picking good stocks. I will always err on the side of caution. This is just my nature. When will I start buying again? I have several indicators that I watch closely for signs of a strong market.

I always watch the indicators of trend and momentum analyses. They will reveal when strength is returning. At some point soon, we will see the advance/decline lines turning positive again. New lows for the NYSE will trend below 50, with the Nasdaq falling below 70. I will start getting serious about buying again when I see the up volume swamp down volume by a 9:1 ratio.

Nasdaq testing September 2001 lows



I also watch leadership in the market very closely. When the OTC and the Russell 2000 are dominating the blue-chip indexes, this tells me investors are becoming more comfortable again with risk. It is very difficult to make money when the NYSE is dominating all indexes.

These indicators, and others, will signal to us that the market is safe to reenter. We won't necessarily buy at the very bottom, but we shouldn't miss much when the trend is in our favor. Even in this market environment, some sectors remain strong.

REITS Providing Leadership

With the exception of the mining stocks, real estate investment trusts are one of the few groups that have been appreciating. The REITS have done well this year as investors have sought out more defensive stocks. REITS, as a group, are not expensive and represent some very good values relative to most stocks.

Additionally, the low interest rate environment has made this sector extremely attractive because these stocks pay some of the highest dividends in the market. Novastar Financial (**NFI**) (recommended in February 2002 and now this month's Stock of the Month) pays 9.7%, Anworth Asset Mortgage Corp (**ANH**) pays 14.7%, APEX Mortgage Capital (**AXM**) pays 12.5%, Impac Mortgage Holdings (**IMH**) pays 12.1%, and Annaly Mortgage Management (**NLY**) pays 11.9%. Those are extremely attractive yields relative to sitting in money market funds that are returning about 1% as we wait for the market to turn back up.

STOCK OF THE MONTH:

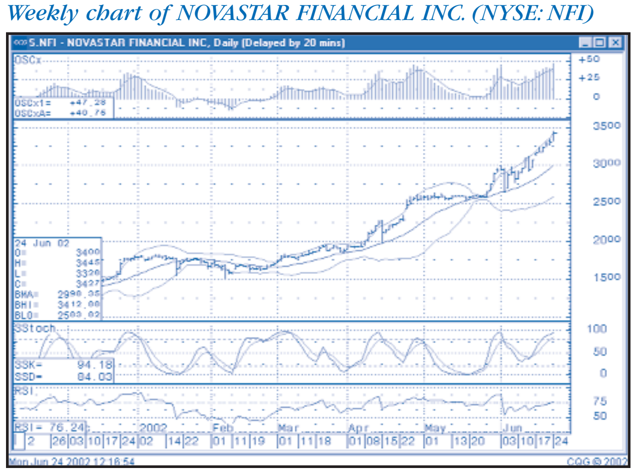
NOVASTAR FINANCIAL INC. (NYSE: NFI)
REIT Cashing in on Low Rates

I first began recommending Novastar Financial (**NFI**) in the January 2002 issue at $15 (+130%) and I added it to my Income portfolio on 3/12/02 at $18 a share (+94%). In just six short months, in one of the most difficult market environments imaginable, NFI has now doubled in price at $35, and in my opinion, could well double again before the end of the year. Even more remarkable is the fact that this company is paying a 9.8% dividend, while you wait for your capital gains to grow.

This company is considered a REIT, but in truth it is more of a mortgage finance company that is cashing in on the low interest rate environment. NFI originates and invests in nonconforming residential mortgage loans. NFI lends to individuals who generally do not qualify for agency/conventional lending programs because of a lack of available documentation or previous credit difficulties, but generally have substantial equity in their homes. Often, these are individuals or families who have built up high-rate consumer debt and are attempting to use the equity in their homes to consolidate debt and lower their total monthly payments.

NFI underwrites, processes, funds, and services the mortgage loans sourced through its broker network. On a short-term basis, NFI finances mortgage loans using warehouse lines of credit and repurchase agreements. In addition, NFI has access to facilities secured by its mortgage securities. At the beginning of 2001, NFI had 63 branches open, and, as of December 31, 2001, there were 123 branches in operation located in 32 states.

Weekly chart of NOVASTAR FINANCIAL INC. (NYSE: NFI)



What really gets me going on NFI is its financial statements. It is growing rapidly, with revenues up 113.14%, net income exploding +319.78%, and cash flow +374.65% from a year ago. For the three months ended March 31, 2002, revenues increased 34% to $18.9 million, while net income jumped from $4.2 million to $8.9 million.

Several well-known institutions, such as Weitz (Wallace) R. & Co., own sizeable chunks of NFI. The owners and insiders of NFI own close to 70% of the outstanding shares. I always like to see the people running the company hanging on to such a large amount of shares.

As a stock, NFI is way undervalued, according to my calculations. The P/E ratio of just nine times earnings is a far cry from what many other fast-growth companies are fetching. Based on my analysis, NFI has an intrinsic value of $71 a share, up over 115% from its current price levels.

NFI is not a growth company in a traditional sense, but in this environment it is making a ton of money. Like all financial lending companies, changes in long-term interest rates will have a profound effect on a company like NFI, but I just do not see interest rates going up until next year sometime. This environment is absolutely perfect for a company like this. I would suggest accumulating this stock below $42 per share.

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STEALTH STOCKS' WATCH LIST

The Stealth Composite is a combination of three factors: inherent value, relative performance and growth and stability of earnings. These stocks are selected from a universe of 10,000 stocks in our database. Each of the 10,000 stocks are ranked on a rating of 1 (lowest) to 10 (highest). These stocks are on our watch list and depending on certain factors could very shortly be added to our portfolios.

RANK	STOCK	SYMBOL	INDUSTRY	STEALTH COMPOSITE	1- MONTH RETURN
1	Wellpoint Health	WLP	Healthcare (HMO)	8	23.8%
2	Total Entertainment	TENT	Food (Restaurant)	7.6	29.8%
3	Hilb Rogal & Hamilton	HRH	Insurance (Brokers)	7.5	17.4%
4	Novastar Financial	NFI	REIT (Equity)	7.5	27.2%
5	United Health Group	UNH	Healthcare (HMO)	7.5	8.3%
6	D R Horton	DHI	Building (Residentl\Com)	7.4	7.3%
7	Lennar Corp	LEN	Building (Residentl\Com)	7.3	15.8%
8	Urban Outfitter	URBN	Retail (Apparel)	7.3	17.5%
9	Amer Nat'l Financial	ANFI	Insurance (Prop\Caus)	7.3	13.2%
10	Cascade Bancorp	CACB	Bank (West\Swst)	7.3	18.2%
11	General Dynamics	GD	Aerospace & Defense	7.3	8.7%
12	K B Home	KBH	Building (Residentl\Com)	7.3	4.0%
13	W. Holding Co	WHI	Financial (Savings/Loan)	7.3	26.9%
14	Wintrust Financial	WTFC	Bank (midwest)	7.3	20.4%
15	AutoZone Inc	AZO	Retail (Auto Parts)	7.2	5.6%
16	Hovnanian Enterprises	HOV	Building (Residentl\Com)	7.2	32.2%
17	Trigon Health	TGH	Healthcare (HMO)	7.2	8.0%
18	Anworth Mortgage Assets	ANH	REIT (Mortgage)	7.2	15.8%
19	Centex Corp	CTX	Building (Residentl\Com)	7.2	10.0%
20	Flagstar Banc	FBC	Financial (Savings/Loan)	7.2	28.7%
21	Impac Mortgage Holdings	IMH	REIT (Mortgage)	7.2	23.1%
22	Mid Atlantic Medical Service	MME	Healthcare (HMO)	7.2	6.4%
23	Hot Topic Inc	HOTT	Retail (Apparel)	7.1	5.5%
24	Knight Transportation	KNGT	Transportation Truck	7.1	8.4%
25	Mississippi Valley Bancsh.	MVBI	Bank (midwest)	7.1	10.1%
26	Mothers Work	MWRK	Retail (Apparel)	7.1	13.7%
27	Shaw Group	SGR	Metal Products	7.1	-2.1%
28	Tractor Supply	TSCO	Retail (Building Product)	7.1	25.6%
29	YOCREAM Int'l	YOCM	Food (Dairy Products)	7.1	66.9%
30	Ambac Financial Group	ABK	Insurance (Prop\Caus)	7.1	6.4%

MONTHLY PORTFOLIO TRACKER

The portfolios listed below are based on our exclusive ranking. Our ranking is primarily based on a 10,000 stock universe that have the highest combination of inherent value, stability and relative performance. Each of the 10,000 stocks are ranked on a rating of 1 (lowest) to 10 (highest). Only stocks ranked 7 or above make it to our portfolio. Due to the rapid changes in the stock market please call our Hotline 1-512-703-8088 (PIN 1810) Monday evenings for weekly updates.

INCOME

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	CURRENT PRICE	TOTAL RETURN	STOP	INDUSTRY
11/19/01	206	CPG	Chelsea Prop	$24.38	$34.05	39.66%	$58.00	REIT
03/12/02	275	NFI	Novastar Financial	$18.20	$33.86	86.04%	$25.95	REIT
04/23/02	435	ANH	Anworth Asset Mortgage	$11.50	$13.45	16.96%	$12.05	REIT
05/07/02	357	OFC	Corp Office Prop.	$14.00	$14.03	0.21%	$13.24	REIT

GROWTH & INCOME

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	CURRENT PRICE	TOTAL RETURN	STOP	INDUSTRY
04/23/02	148	CBSS	Compass Bancshares	$33.72	$32.37	-4.00%	$32.07	Bank (SW)

MODERATE

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	CURRENT PRICE	TOTAL RETURN	STOP	INDUSTRY
03/12/02	77	PII	Polaris Industries	$65.24	$68.51	5.01%	$66.00	Leisure

AGGRESSIVE

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	CURRENT PRICE	TOTAL RETURN	STOP	INDUSTRY
04/30/02	129	NFB	North Fork Bancorp	$38.62	$38.25	-0.96%	$36.00	Bank (NE)

TRADING PORTFOLIO

DATE ENTERED	SHARES	TICKER	COMPANY NAME	INITIAL PRICE	CURRENT PRICE	TOTAL RETURN	STOP	INDUSTRY
04/23/02	270	HCBK	Hudson City Bankcorp	$18.50	$20.52	10.92%	$34.72	Bank (NE)

FIVE STOCKS THAT COULD DOUBLE IN A YEAR

1. **J2 Global Communications (JCOM) $14**
   J2 Global Communications provides outsourced messaging and communications services to businesses and individuals throughout the world. The company offers faxing and voice mail solutions, Web-initiated conference calling, document management solutions, and unified messaging services. J2 Global markets its services principally under the brand names eFax and jConnect. For the three months ended March 31, 2002, revenue rose 44% to $10.4 million.

2. **Curative Health Services, Inc. (CURE) $14**
   Curative Health Services, a disease management company in the chronic wound care business, operates a network of Wound Care Centers offering comprehensive wound treatment programs. For the three months ended March 31, 2002, revenues rose 68% to $22.8 million. Net income totaled $2.1 million, up from $492,000.

3. **Standard Management Corp. (SMAN) $8**
   SMAN is an international financial holding company that, directly and through its subsidiaries, develops, markets, and administers profitable life insurance, annuities, and unit-linked assurance

in force business and products. For the three months ended March 31, 2002, revenues rose 21% to $23 million.

4. **APEX Mortgage Capital Inc. (AXM) $15**
Apex Mortgage Capital, Inc. is a real estate investment trust engaged in acquiring U.S. agency and other highly rated, adjustable-rate, single-family real estate mortgage securities and mortgage loans. For the three months ended March 31, 2002, total revenues totaled $27.3 million, up from $11 million. Net income before acct. chg. totaled $9.7 million, up from $3.1 million.

5. **Humboldt Bancorp (HBEK) $15**
Humboldt Bancorp is a multibank holding company with three state-licensed bank subsidiaries and a leasing corporation. Humboldt is the owner and manager of its wholly owned subsidiaries, Humboldt Bank, Capitol Valley Bank, Capitol Thrift & Loan, and Tehama Bank (collectively, the Banks). The Banks provide general commercial banking services at 25 locations, generally located throughout Northern California. For the three months ended March 31, 2002, net interest income rose 26% to $10.3 million. Net income from continuing operations totaled $3 million, up from $173,000.

ON A PERSONAL NOTE

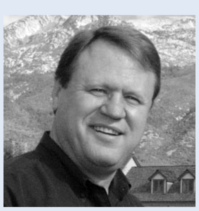
I hope you enjoyed the new layout of Stealth Stocks. My publisher and I have made several changes in order to help you understand my advice more clearly and get you the information you need more readily. My goal with Stealth Stocks is to guide you through the canyons of Wall Street in order to achieve your financial goals.

With the risk of "tooting" my own horn, I had some nice press since last month's edition. Apparently, the June 2002 issue of Stealth Stocks was making the rounds at the newsrooms. My lead article on the Fed Cycle was picked up by Peter Brimelow of www.CBS.Marketwatch and a few weeks later I was interviewed by Ben Berentson of www.Forbes.com. On June 17, Bob Pisani of CNBC also mentioned the article before the closing bell. If you want to read what they had to say, log on to our new web site at www.StealthStocksOnline.com. As always, you will get the inside scoop each month in Stealth Stocks way before the media ever gets wind of it.

Please feel free to contact me at Dennis@StealthStocksOnline.com with any questions, suggestions, or comments. I am here to serve you and keep you a part of the Stealth Stock's family.

Until next month,

Dennis Slothower
Editor, Stealth Stocks



Dennis Slothower is a veteran financial analyst, widely read author and popular speaker. He is the editor of Stealth Stocks and On the Money (for mutual fund trading). Dennis is consistently ranked as one of America's top five investment advisors by the fiercely independent Hulbert Financial Digest. Dennis invites you to write him by mail or send him an e-mail at Dennis@StealthStocksOnline.com You may also inquire information about his private money management services