CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

January 14, 2009

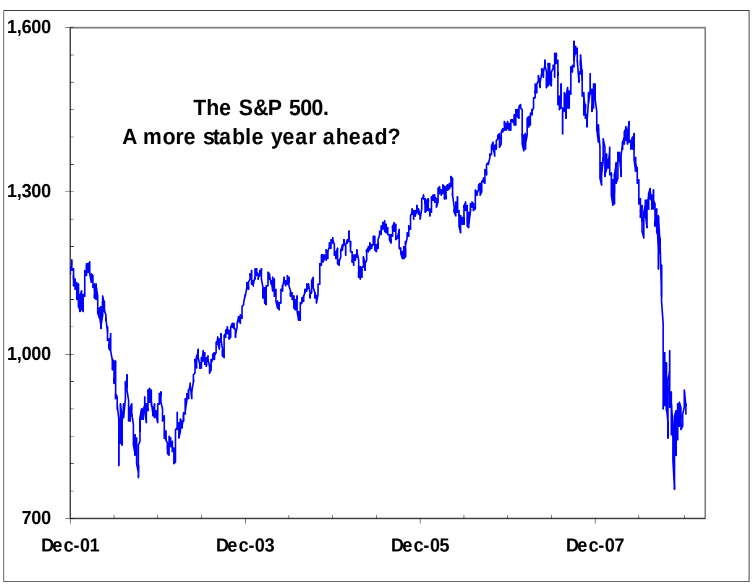
A New Administration ….
….Confronts Old Problems

Credit markets have improved and stock markets have risen since the November Citibank crisis.

The economic news is dreadful, so we are focusing investments in high-grade, US bonds.

The calendar has turned and the Obama administration is fully at work, but profound economic, banking, and investment problems continue. The sense of crisis has abated significantly since late November when Citibank was on the ropes. Bonds and stocks have both rallied and credit markets are beginning to function. Last week, as the new year began, some big companies sold bonds again. GE sold 30-year bonds, the first sale by an American financial company of non FDIC-backed, long-term bonds since September. The extreme swings in prices have subsided and it begins to seem that one can again make investment judgments based on analysis of the economy.

Economic conditions are dire. Jobs are being lost at a terribly rapid pace. The Commerce Department's estimate last Friday is that 2.6 million jobs were lost in 2008, 1.1 million in November and December, alone. (Note that about 1.5 million Americans enter the work force each year; thus in 2008, the country missed maintaining a steady state in employment by more than 4 million jobs.) The economy is almost certainly continuing to contract; the recession is now in its second year. It is an open question, of course, whether the recovery package that Obama and Congress are negotiating will stop the vicious cycle of economic contraction. However, we can make investment judgments about this and can earn money in this environment. As economic contraction continues, we should--and we are--investing in high-grade bonds. In the crisis atmosphere of last autumn, the bonds of even the most credit-worthy companies plunged in price, as debt markets froze and investors panicked. Now, these bonds are recovering in price and moving toward more traditional 'spreads' over treasury bonds. This trend will continue. We began making investments in these bonds early in December and are in the process of adding to our positions.



In our judgment, it is too early to invest more in the riskier assets. When we have evidence that the economy is improving--for example, that payrolls are growing again--it will be time to invest in lower-grade bonds and to make further equity investments. There is a widely held view that the economy will begin to improve in the second half of the year. It may. However, there is enormous uncertainty and such views can be little more than guesses. We have some equity investments in undervalued blue-chip stocks and in sectors

By

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We are continuing to invest in bonds of financially strong US companies.

We will invest in riskier assets when economic conditions become more stable.

that should benefit from the public works spending that will be a key component of the Obama stimulus package. We still hold large amounts of cash, but less after our recent bond investments. I do not know what will bring it about, but I expect that we will have at least one more wave of panic and intense selling in stocks in coming months. As we emerge from that round, we can make our judgments about further equity investments. If we act with a careful mix of caution and opportunism, we will make favorable investments with our big hoard of cash and high-grade bonds and we will earn a very attractive investment return.

Inflation. With the Federal budget deficit in the current year certain to exceed $1 trillion, with larger deficits ahead as the world applies Keynesian approaches to the credit crisis and recession, there is anxiety about inflation. Yields on the benchmark ten-year US treasury bond fell to 2.1% last month, a half-century low. But, as the Fed's balance sheet balloons and the government issues heretofore unheard-of quantities of bonds, notes and bills, there is fear that yields may skyrocket toward the inflationary levels of the late seventies and eighties.

There may be high inflation in time, but inflation and high bond yields seem unlikely for now. Yes, the United States government and other governments around the world are spending far more money than they are generating from tax revenues. In a sense, however, governments and central banks are merely stepping in to spend while the private sector saves. Companies are hoarding cash, fearful for their survival. Individuals are saving to pay down debt and prepare for even worse times. Corporate and consumer spending is collapsing and private saving is rising significantly. Governments and central banks are stepping into the breach to counter these effects and to keep economies from shriveling.

Until we see some evidence that the recession is not worsening--and in recent months, the fall in economic activity has accelerated--the risk is deflation and still lower yields on treasuries. In the last couple of weeks, the yield on the ten-year treasury rose toward 2.5%. Now this is still an exceptionally low yield, but do not be too surprised to be reading in a few months that the stimulus plans don't seem to be working, that the economy is falling further, that banks are still not lending, that the Federal Reserve is buying long-term government and corporate bonds, and that the yield on the ten-year has fallen well below 2%. As investors, it is quite sensible for us to think about future inflation and about a renewed collapse of the dollar's value. However, in this period of extraordinary crisis, we must attend to the present and to shorter-term considerations. We must necessarily be tactical in our investments and save the big, long-term investment decisions for the time when we can do more than just guess about the future.

Each year Core Asset Management files with the SEC a form ADV with information about our company. If you would like a copy of Part II of Form ADV, please contact us.

Our 'strategic'--as against 'tactical'--judgment for the last two years has been to keep cash levels high and to keep cutting our investments in risky assets. We have lost money in accounts we manage during this period, but far less than the markets as a whole. As we read the statistics, Core's accounts have declined by far less than the overwhelming majority of mutual funds and active investment managers. The crisis is by no means over. We must continue to keep the risk to your investment capital low, because external risks remain very high, indeed.. However, there is a reasonable chance that we are closer to the end of all this than to the beginning. We are considering inflation and the fate of the dollar--and we are considering the means to earn investment returns if and as those things unfold. We are planning to invest in very cheap assets with very good prospects, when we have a clearer sense that the end of the crisis is in prospect. With a proper mix of thought, care and action, we will all emerge intact.

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