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

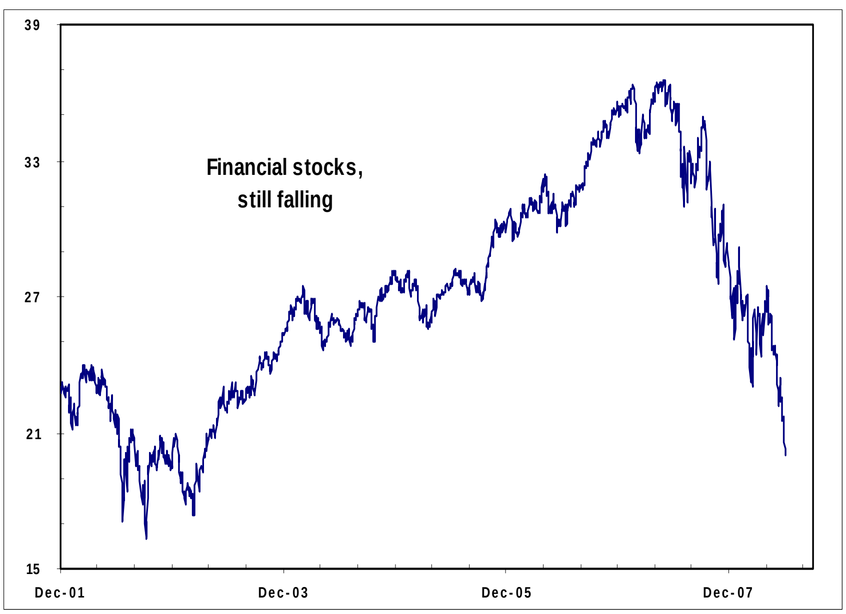
July 1, 2008

June

We are taking care of your capital while things are so difficult. We hold lots of cash in your accounts. There will be plenty of time and plenty of opportunity when the dust settles.

The markets have closed the books on June 2008. None too soon. Having written a substantial letter and made a serious effort to discuss the global investment situation in broad terms just two weeks ago, I had not expected so soon to be putting pen to page. The investment gods seem not to want those of us plying the trade to slip away for too-early vacations. First, the markets' results and Core's, then a discussion of our investment decisions.

For the month of June, the S&P 500 declined by 8.6%. Ouch! Because of decent returns in April and May, Core's portfolios actually earned some money for the quarter as a whole: up 1.2% in the aggregate. Not spectacular by any measure, but lots better than the stock market: the S&P 500 *fell* 3.2% in the second quarter. For the half-year to date, our accounts and the US market's as a whole are both down, but the comparison is favorable; Core's accounts have declined by less than half the amount of the S&P 500's 12.8% loss.



The SEC rightly insists that when we discuss investment returns we qualify our discussion in lots of ways: In order to keep the flow of our argument, we have written about this in a box on the upper left side of the other page of this letter. We invite you to read it.

Fears about the recession, the worsening inflation from ever-higher oil and food prices, the continuing collapse in US housing prices, and the contraction of credit affecting borrowers from the top to the bottom of the system seemed to heighten day by day in June, giving rise to the worst June for US stocks since 1930. (Oil traded at about $50 per barrel early last year, $143 this week. Yikes.) As the month progressed and prices fell, we reduced our equity investments further. We went into June holding 35% of clients' assets in cash and bonds (including both US dollar and foreign currency positions). By month's end, we had raised these positions to 40%, in part by selling our investment in US financial stocks, a graph for which is shown on this page.

By

Jack Mayberry

The banks and brokers. In late January, we bought an exchange-traded fund that holds the banks, brokers and insurers in the S&P 500, and wrote about it in several letters earlier this year. The primary ideas in making this investment include the notion that despite the huge losses--which now exceed $300 billion, from the many very stupid decisions of these geniuses of high finance--the global franchises of the major commercial and investment banks give them a prime spot to earn money from the mediation of global capital flows in the years to come. Thus we were quite confident that these firms would find new capital as needed, from Sovereign Wealth Funds and other institutional investors, to repair balance sheets. When Bear Stearns collapsed in March, the Fed took $29 billion of Bear's dodgy assets onto the Fed's balance sheet and gave assurance that it would provide similar support for the other major investment banks.

Although the Fed's action really put an end to the fears of systemic collapse from the travails of Bear, Lehman, Merrill and the others, it brought into focus for us the process of 'deleveraging' the balance sheets of the big investment banks. It is certain that, in exchange for the Fed's willingness to permit investment banks to use its credit, the investment banks will come under new regulatory supervision. One aspect of this will probably be limits on their leveraging of assets. When Bear collapsed, it had assets thirty times greater than its equity base. The use of leverage certainly gave Bear and the others greater earnings when credit conditions were good, but it completely destroyed the institution when it began to lose large sums on investments made with its borrowed money.

If investment banks will be able to borrow less on their equity in the future, their potential returns on equity may be permanently reduced. Over the recent months, the banks, insurers, and brokers have continued to write down enormous losses. It now appears that when this round of losses comes to an end, we may be left with financial institutions with less earning power. We made our investment in January, after the group as a whole had fallen by about 30% in price since last spring. As the likely outcome of deleveraging became apparent and more multi-billion losses were recognized, the group lost another 25% in May and June. We sold your positions, recognizing that we made the investment too soon.

These global financial organizations will come out of this period intact and with considerable--if diminished--earning power. We will watch the sector closely and we may revisit this idea in the future. As my partner John Forlines pointed out in his recent letter, major stock market sell offs often feature the collapse of an important financial institution.

We made another sale last week, that of our Indian equity investment. As mentioned in a recent letter, some developing countries are still growing very strongly, largely unaffected by the economic slowdown here. India is among these. However, its stock market is not the same as its economy. It has been weak and looks likely to fall further in price. Emerging markets did extremely well for the last several years for a variety of reasons. One had to do with global liquidity and appetite for risk. Liquidity and appetite for risk are shrinking now; we decided to sell India to raise cash in our portfolios.

We are a year into this bear market and the unraveling of credit excesses. How much longer? Certainly financial markets, credit conditions, and the economy will improve. There are good values now; there will be more and better ones in the future, and we expect to earn fine investment returns for you in the years ahead. There are also real uncertainties right now, in economies and in the markets. Given the uncertainties, preserving your capital is key. We are attending first to capital preservation and believe we are succeeding. There will be lots of money to be made in the next three years. We intend to earn a good portion for you.

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