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

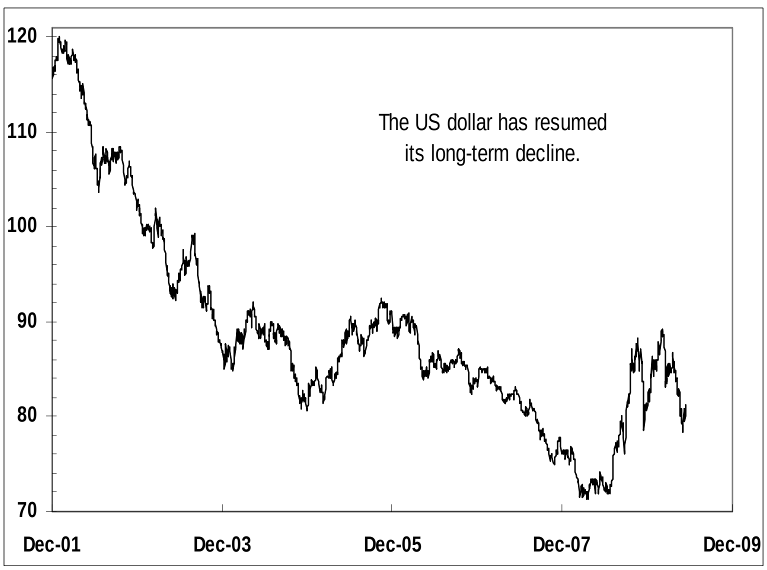
June 17, 2009

Back from the Abyss

There is a growing conviction that the worst has past for the US economy and for the banking system. The recession continues and further bank losses lie ahead, but financial collapse and economic depression seem remote possibilities.

Acute fears of collapse of the banking system and of economic depression began to abate early in March. By then, the stock market had fallen by 25% in the nine weeks of the new year, after a really dreadful 2008. Job losses in the United States were running at the rate of more than 600,000 per month; major banks teetered at the brink of insolvency. There were real doubts that the Federal Reserve and the Treasury had the capital or the wit to prevent the collapse of the system and descent into economic depression. Armageddon was at hand; investment markets priced in collapse.

By stages since early March, a degree of confidence has been restored and we have pulled back from the abyss. Recently, some large banks that received so-called TARP funds last autumn have successfully raised tens of billions of dollars in private markets. The Treasury is permitting ten banks to repay $68 billion in TARP funds. Even though banks will sustain further losses from commercial and residential real estate, credit card debt, and student loans, the risk of collapse of banking and financial systems now seems remote.



Although the US economy and most other economies in the world continue to contract, the rate of decline is lessening. Leading economic indicators are beginning to rise. Confidence in future economic conditions strengthens. It is likely that the economy will begin to grow later this year.

Core's investments. As you know, during the course of 2008 and in January and February of 2009, Core cut equity investments sharply, closed out our foreign currency and commodity positions, and raised significant amounts of cash. Beginning in December 2008, we began to invest in high-grade US bonds, including corporate bonds. In March, we began a slow process of reinvesting in other assets to benefit from improving conditions. Without elaborating on specific investments, we have built positions in stock markets of developing economies (in Brazil and around China), we have invested in foreign currencies (including the euro and the Canadian and Australian dollars), we have purchased commodities, and we have added some US equities. We have reduced cash positions to quite low levels, and built further positions in US bonds.

By

Jack Mayberry

Investment markets are likely to have the usual rounds of selling, and economic recovery may be halting.

Despite this, we are in very early stages now of what will probably be a very strong and extended period of rising investment markets.

Sign posts for future investments. A rather sharp, "V-shaped" economic recovery is possible in coming months, as businesses restock after the terribly sharp contraction from September through March. It is also quite probable that job losses will continue at a high rate for many months, well after economic recovery begins. If so, consumer spending will probably remain low and savings will probably stay relatively high. These factors will restrain economic activity. After a rebound in economic activity later this year, a long period of poor economic growth is likely, probably interspersed with occasional episodes of contraction.

Meanwhile, yields for US treasuries increased dramatically in recent weeks. In December, near the worst of the crisis, the ten-year Treasury yielded 2.06%; last week the yield rose to 4.01%. These increases have come in the context of huge federal budget deficits and correspondingly large issuance of new treasury notes and bonds. There is discussion of still higher rates and high inflation. Markets and some commentators are putting pressure on the Administration and on the Federal Reserve to unwind the extraordinary series of actions to recapitalize banks, save GM and Chrysler, and stimulate economic activity. It seems to me that it is far too soon to tighten fiscal or monetary policy. The banking crisis and the recession are not over; the effects will linger and cause new problems even after the economy reaches its low point. High interest rates and high inflation are not in the cards for the next year or more.

The chart on the front page shows the dollar's long decline from 2002, then the brief and sharp recovery during the crisis. Dollar depreciation has again resumed. It will continue.

In a sense, our recent investing has the effect of restoring a quite moderate investment stance, after the months when our investments were designed to protect against the "Armageddon risk". Although cash positions are quite low now, our bond positions are considerably higher than normal. The bond investments play two roles: first, they are low-risk investments, second, they have offered very favorable returns, because corporate bond prices themselves fell very sharply after the collapse of Lehman Brothers in September.

It is likely that world economies will begin to recover this year, although most are still contracting sharply. The world's banking system will regain its footing, although lending will probably be much more restrained. Prices of commodities and of economically-sensitive industries have already been rising; these suggest reflation. It is a reasonable bet that global stock markets will appreciate significantly in the next two years. Similarly, the dollar, which rallied very sharply in the worst stages of the crisis, will depreciate much further in coming years. Our investments for you stand to do very well over the next two years. In time, we expect to reduce corporate bond investments and increase equities, commodities, and foreign currencies. Commercial real estate investments are becoming quite attractive once again; these lie ahead for us.

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.

In short, after a terrible year and more in investment markets and the world's economies, the pendulum is swinging back to economic growth and strong investment markets. This is a very favorable time to be an investor.

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