

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

October 9, 2010

A Review of Investments

After a series of changed investments in the last few weeks, it seems useful to give an overview of the specific investments Core has made for you.

Despite the poor economic environment, many investment assets are rising in price. The Federal Reserve appears to be in early stages of a second round of quantitative easing; the Japanese Central Bank is independently pursuing strategies to revive Japan's economy and to reverse the rise in value of the Yen. Countries big and small are taking actions to keep their currency values low. (The European Central Bank is the notable exception, for now. As a result, the Euro is rising.) These concerted central bank actions are part of the reason for rising prices of stocks and other assets.

The effects of these actions on weak economies are uncertain. The US economy is growing very weakly, so weakly that the jobs are being lost once again, an unusually alarming sign at this stage of the economic cycle.

By

Jack Mayberry

Domestic fixed income. Since the Fed began to lower short-term interest rates sharply over two years ago, we have avoided holding much capital in money market funds, which pay essentially nothing. Instead, we have held your reserves in high-grade, medium-term bonds, mostly via Pimco Total Return (symbol PPTDX or PTTRX) and an exchange-traded fund holding high-grade US corporate bonds (LQD). We regard these as quite safe with very little risk of loss of principal value; they have paid interest of more than 5% and have increased in price over the last couple of years. We have three other US bond investments, high-yield corporate bonds (HYG), long-term US treasury bonds (TLT), and very long-term zero-coupon US treasuries (ZROZ). The two treasury investments are based on the notion that long-term US treasury bonds, already at record low interest rates, will go lower still in yield and higher in price because of the grave economic weakness and the Fed's so-called 'quantitative easing', by which it is buying long-term treasury bonds. The high-yield corporate bonds pay more than 8% in interest and have risen in price as corporate balance sheets have strengthened, a process we expect will continue. Our total investments in domestic fixed income for clients (including the small money fund holdings) range from 17% to 30%. As you can see, we are not in the camp that believes that bonds are a bubble and that inflation is at hand.

Foreign bonds. These investments are all denominated in foreign currencies; as such they benefit from a decline in the value of the dollar against other currencies. Our largest investment in this category is in a closed-end fund holding bonds issued by developing countries, symbol EMD (for 'emerging market debt'). As discussed in previous letters, many of the developing countries are very strong financially, with large current account and trade surpluses, and enjoy strong economic growth, young populations, and few long-term obligations for medical care and pensions that loom so large in the United States and European countries. Happily, the interest rates paid on these bonds are higher than in the developed countries, despite their better financial characteristics. Even after big gains in this investment since we have owned it, EMD still yields more than 6.5%. Further gains are in store. We continue to have short-term investments in Canadian and Australian dollar funds (FXC and FXA, respectively), which yield more than US money funds and whose currencies have strengthened considerably against the dollar. In total, our foreign bond and currency investments range from 13% to 20%.

The value of the US dollar rose sharply at the worst of the financial crisis and again when economies were recovering well. Now, as the economy weakens again, the dollar is falling. The crisis in the banking system is over, but economic damage persists.

US Stocks. Our US stock investments are in three funds, one for utilities (XLU) for their relatively high 4% dividend yield, a second fund of big companies with long, uninterrupted history of increasing dividend payments (SDY), and a third fund holding preferred stocks of big US banks (PGF). This last holds mostly preferred stocks of the very large banks, which the United States has clearly indicated are 'too-big-to-fail', affording them, in effect, the protection of the United States. These are safe investments; preferred stocks are high in the corporate capital structure and safe for that reason, and they carry an attractive yield of more than 7%. Overall US equity investments range from about 17% to about 23%.



Foreign stocks. Our foreign stock holdings are more numerous and largely focused on the developing countries, including country-specific investments in Malaysia (EWM), Indonesia (IDX) and Brazil (BRF), resource-rich, dynamic economies. We also hold the broad fund for developing countries (EEM) and two country-specific developed country funds, Canada (EWC) and Sweden (EWD). Lastly, we hold the Eaton Vance closed-end fund (ETG) in which we are long-term investors. This holds mostly large foreign companies, many in developed countries, and some large US companies. We purchased this at a very favorable price during the crisis; it has recovered very well and still pays a large dividend.

Gold and commodities. We have built a fairly large position in gold over the last two years through a fund with the symbol GLD. Gold is seen, probably appropriately, as the counter to paper currencies, whose issuers--the major governments--are engaged in a worrisome, but understandable race to depreciate. Gold recently reached \$1350 an ounce; it is making all-time nominal highs against all major currencies, a process that will probably continue. We have recently made an investment in a fund (DBA) holding agricultural commodities. Our total gold and commodity investments range from 8% to 11%.

Real Estate. Finally, we have added to our small commercial real estate investments, which we hold via a mutual fund, symbol TAREX, and an exchange-trade fund, ICF. These investments amount to 3% to 7%.

There is variation in holdings among our accounts for reasons of risk tolerance and return goals, as well as a range of other specific considerations for individuals. Apart from the portfolios discussed above, we manage a group of accounts for clients that holds only bonds and gold, our most conservative set of accounts, which have, as it happens, performed very well in this extraordinary environment. Please contact us if you wish to discuss any matters individually with us.

A Further Note on the Mutual Fund Settlements

We think we have contacted all of you who may benefit from the recent mutual fund settlements to facilitate the collection of your share of the judgments. We will be able to file claims on your behalf. A number of large mutual fund groups have recently settled claims arising from a set of ugly practices, so if and as you receive notices in the mail, you might contact us to see if we can act on your behalf. Please contact Margo or me if you have questions about this process.

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.

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