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

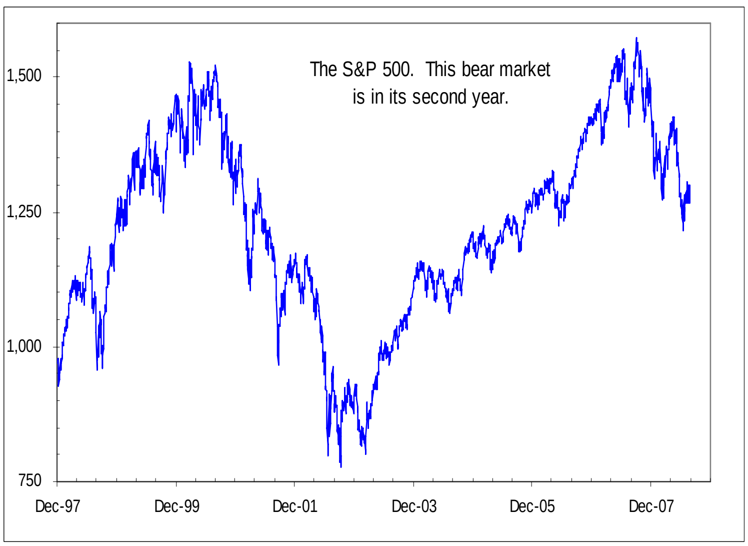
September 2, 2008

Summer's Ending

Unbridled optimism about the investments markets would be fun to deliver. There is little basis for it yet. The task is to manage these difficult straits, to keep our capital safe, to emerge intact, and to invest vigorously in the opportunities that will then present themselves. We're working at it.

Tumultuous market conditions prevailed all summer. Prices for oil and other commodities fell sharply. The dollar staged a very strong rally. Stock prices moved sharply up and down, with wide swings in prices characteristic of bear markets. Investment market drama unfolded against the backdrop of severe banking problems and weakening economies around the world.

Uncertainties in credit markets and the still-unfolding collapse of home prices in the US are the causes of the poor stock markets. The housing market is the heart of the problem. Conditions may be stabilizing in some parts of the country, but no one can know how long housing problems will persist and how bad they may get. Financial institutions hold enormous amounts of mortgage securities. As conditions worsen, more home owners default on mortgages, more homes are foreclosed and more banks must recognize ever-greater losses on their housing-related investments.



In recent years, when credit conditions were benign, banks used ever-greater quantities of borrowed funds to make investments. All this has turned upside down. Commercial and investment banks are selling their investments and reducing the levels of their borrowing. The 'deleveraging' of banks' balance sheets is itself causing asset prices to fall: there are simply far too many sellers of mortgage-related securities. Buyers can wait for prices to come down before risking their capital. This process creates a vicious cycle of falling prices and an increased need to reduce investments and shrink balance sheets.

Unsurprisingly, economic conditions in the United States are poor. Employment has fallen every month this year. The bright spot in the American economy has been exports. The weakness in the US dollar has made US goods cheaper abroad. Now however, the dollar is strengthening just as economic conditions in Europe weaken. Weak economies in Europe and Asia will reduce demand for American exports. Further uncertainties; further reasons for investors to stand aside.

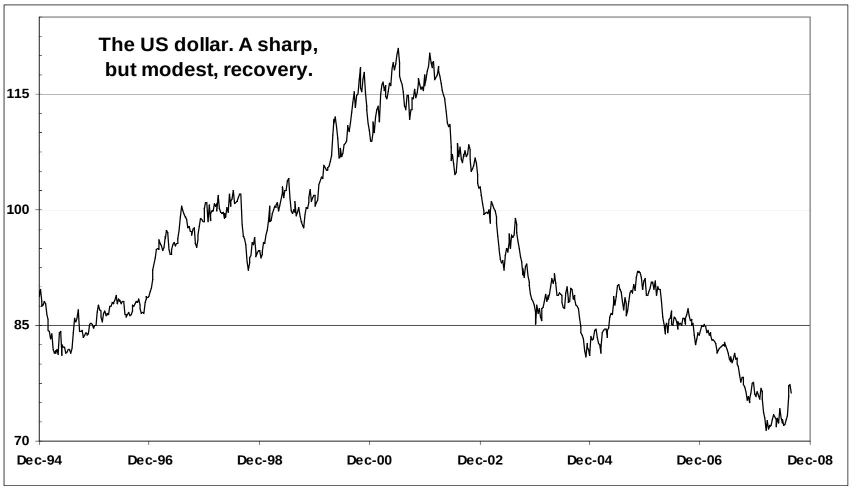
By

Jack Mayberry

Investments. We hold large cash reserves in client accounts. Losses in your accounts have been far less than in the stock markets. As oil prices began their recent slide, we sold most of our oil-related investments, positions we had held for more than four years. Since March, when holdings of foreign currency money market funds were about one fourth of your total investments, we have sold all such investments, in response to the strengthening dollar. We have reduced our total equity investments sharply.

Oil and other commodities have fallen sharply. The dollar is rallying. Are these connected? You bet. Has the dollar finally stopped going down against other currencies? Maybe. Everything is more volatile these days, including currency exchange rates. It will take a couple of years, at least, for this long-run decline in the dollar's value to change course.

We are well into the second year of this bear market. While we maintain large defensive positions, we have made and plan to make investments to take advantage of the opportunities we see. This occasions more trading than we undertake in bull markets, but is, we submit, an appropriate way to extract value from these turbulent markets. We expect at least one more sharp sell off in stock markets akin to the one in June and July. Probably this will be occasioned by more poor developments in credit markets: there is risk of more bank failures and the need for more capital by the Federal Deposit Insurance Corporation, the guarantor of deposits. Banks may suffer large losses in credit card receivables and auto loans. Further weakness in housing and the mortgage-backed securities market may trigger more banking losses and another wave of selling. When and if that sell off comes about, we will probably have some better information about the likely duration of the bear market.



The US dollar has made a sharp recovery in recent months after falling for six years. The dollar's bear market is beginning to end--or so I think--but it may be a good long time before the dollar makes a sustained advance. We have closed out positions in various foreign bond and money market investments. We began this round of non-dollar investments in the summer of 2002; they have been very successful. We have not abandoned foreign investments by any means; we still hold non-US equities. I am quite certain that we will continue to make large investments outside the United States; it is very likely that emerging economies of India, Brazil, China and others will grow more rapidly than America's. For various (good) reasons, the dollar is now rising and we have pared our non-dollar investments to the bone.

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Looking ahead. In the fullness of time, we can discuss the failures of public policy and private banking decisions that led to this unhappy juncture. The sense of crisis is sometimes palpable, most recently when Bernanke and Paulson testified in Congress about Fannie Mae and Freddie Mac. Will the present crisis and the provision for (unlimited) public support for these failing entities lead finally to proper legislation dealing with credit issues? Don't hold your breath. Will we resolve this situation in which the private owners of Fannie and Freddie get paid when F & F 'earn' money, but the US taxpayers pay for the losses? These entities should be nationalized; good stewards of the public purse should manage their assets and liabilities carefully; and the US Treasury (i.e., the public) will make a very good profit.

Whether or not we emerge from all this with good public policy is an important question. That answer notwithstanding, we can be certain that financial markets will accommodate themselves to whatever emerges. Housing markets will settle down. Banks will confess their losses. The election will come and go. We have lots of cash in your accounts and we expect to recognize the end of this turmoil. This is not an easy time to invest, but we are doing it carefully and, I believe, we are doing it well. We'll keep working at it. Call or email; we'll discuss all this in more depth. (JNMayberry@coreasset.com or 800 451 2240.)

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