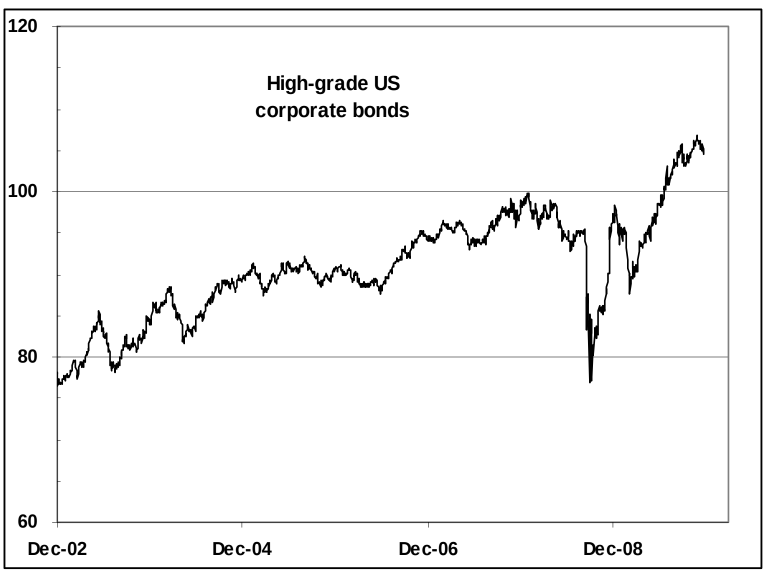
CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

December 27, 2009

Ahead to 2010

The chart below, showing the total return for high-grade US corporate bonds, depicts the superb recovery of corporate bonds in 2009. High-yield corporates did even better. Prospects for corporate bonds remain favorable and we retain large investments in them.

To give context to the present situation and what it holds for investment assets in 2010, a few words (once again) on the situation 15 months ago may help. As the crisis worsened during the summer of 2008, risks loomed very large and the speed with which conditions worsened was breathtaking. The Federal Reserve, Treasury, and Congress were obliged to make decisions of enormous consequence with little time to reflect on possible outcomes. Fannie Mae, Freddie Mac, and AIG were given essentially unlimited support by the Treasury and the Fed. Over a fateful weekend in September 2008, Lehman Brothers was allowed to fail and Merrill Lynch was pushed into the (willing or unwilling) embrace of the Bank of America. Policy makers knew that if Merrill failed, Morgan Stanley, Goldman Sachs and GE would collapse very quickly. The world's banking systems would fail and severe economic depression would engulf the world.



The actions by the Fed, Treasury, and Congress (and their counterparts in other countries) turned out to be sufficient to prevent the collapse of the banking system, the world's economy, and financial markets. The damage that did occur was bad enough. Let one example stand for many: In the fourth quarter of 2008, the dollar volume of world trade shrank at the rate of 56% per year, a decline in trade without precedent.

Recovery. In the spring of this year, it began to appear that the worst would be avoided: private credit markets sputtered back to life, stock markets ended their free fall and began to recover, and the economic recession began to abate. By the summer, investment assets of all kinds were rallying very strongly and some major economies, including America's, began to expand. In this fourth quarter of the year, investment assets continued to appreciate and economic growth broadened to include most of the world.

And so, into 2010. The Fed promises that the extraordinary monetary conditions--designed to effect the recovery in confidence, in economic activity, in the credit markets, and in investment assets--will remain in place for "an extended period." Given how close to the brink we came a year ago, the Fed will certainly err on the side of maintaining accommodative monetary conditions too long, rather than risk a second round of catastrophe by tightening conditions too soon. Short-term interest rates will stay near zero and the measures of "quantitative easing" will only slowly be unwound. Economic

By

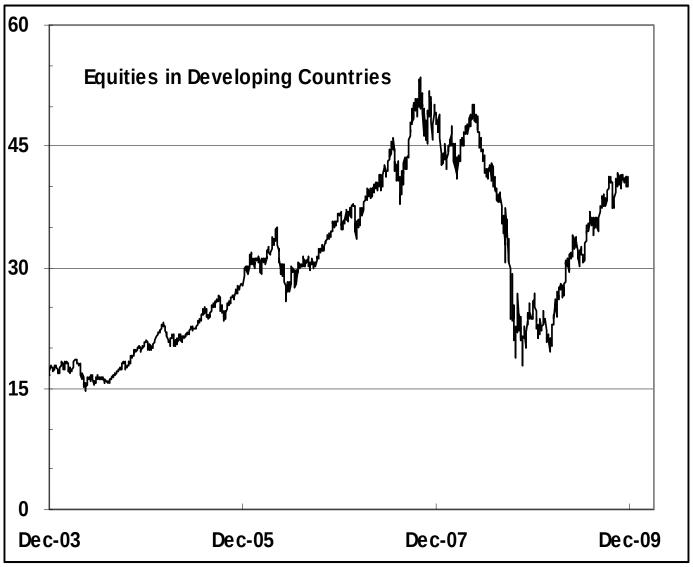
Jack Mayberry

growth will be reasonably strong in the coming months. Even the labor market will improve and employment will grow after this disastrous two-year period of job losses.

The strong increase in stocks from emerging economies is shown in the chart below. The dynamic development in Asia and Latin America will continue. We will continue to invest in these regions.

Investment assets, including stocks, commodities, and corporate bonds, will continue to be strong in 2010, but the pace of their gains will surely be slower than we observed in the middle of 2009. Already the rally in stocks, bonds, and commodities has moderated from the explosive mid-year rate. We should expect only modest price gains in coming months, but favorable returns are likely.

As we see it, the investments with the most promise include equities of developing economies, especially Brazil, Indonesia, and other South Asian and East Asian countries. Commodities and energy will also appreciate. We expect that the dollar's value will continue its decline against many currencies. However, two other principal currencies, the yen and euro, are both beset with local problems, Japan with seemingly endless deflation and recession, poor public finances and very unfavorable demographics, and Europe with severe economic weakness in its peripheral countries, Greece, Italy, Spain, and Ireland. Hence we focus our foreign currency investments in Australia, Canada, and emerging economies.



Inflation in investment assets, not consumer prices. The unprecedented size of the federal deficit--14% of GDP, three times the level of deficits early in the decade--gives rise to fears that rampant inflation lies ahead. The happy irony for investors is that deficits and excess liquidity will cause inflation, but of a kind we favor: The prices of investment assets will become inflated, while consumer price inflation will remain subdued.

Economic activity has been so slow and private borrowing (that is, borrowing by people and companies) so weak that government deficit spending and government borrowing is merely making up for the absence of spending and borrowing in the private sector. Monetary conditions and fiscal policy are causing inflation right now --but the inflation is in asset prices not consumer prices. Excess liquidity and deficit spending are causing prices of stocks and bonds and commodities to rise, but slack in labor markets and factory output keeps consumer prices and wages very low. Consumer price inflation may lie ahead, but it is not the problem for 2010.

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As the year ends….

Please accept our thanks for the privilege you have given us at Core to serve you and to invest your capital. The personal side of this business--the individual work with you--is a pure pleasure. The intellectual side of it--the attempt to understand how the events in the world affect investments--is endlessly fascinating. These last two years have put a finer edge to all of this: one could sometimes have wished for a more placid occupation than the investment business over this period.

We deeply appreciate the opportunity to work with you and for you, and look forward with anticipation to the coming year. We wish for you peace, health and prosperity in the year ahead.

CORE Comments

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November 25, 2009

CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

Genesis of the Crisis, Policy Response, and Aftermath

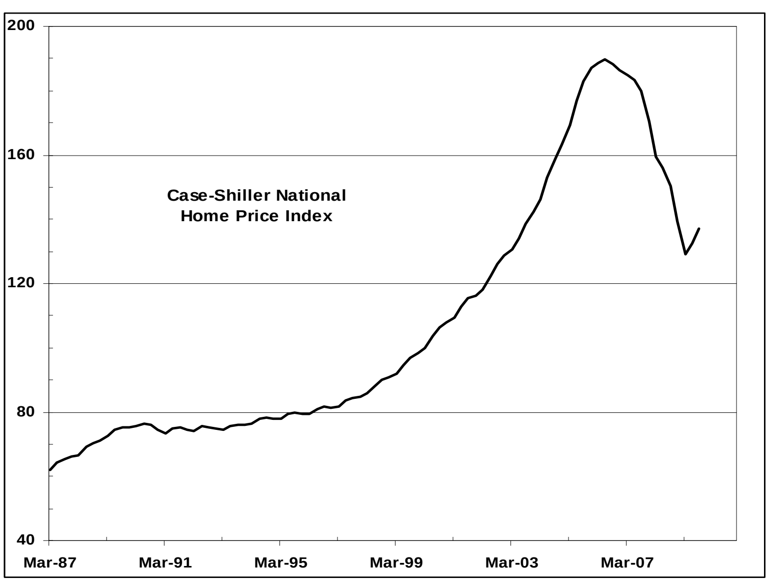
By

Jack Mayberry

Enough time has passed to give a picture of the causes and nature of the financial crisis and the policy decisions made to deal with it. Enough time has passed for us to see some effects of these policies and to form preliminary judgments about their wisdom. In this letter and subsequent ones, we (a) examine the genesis of the crisis and its evolution, (b) consider the actions taken by governments and central banks in response to the crisis, (c) review the effects of these actions on the economy, the financial markets, the political tone of the country, and (d) put forward some ideas about what lies ahead. This letter provides a summary of these topics:

I. Introduction and Summary

A. The Genesis of the Crisis. The financial crisis flowed from a combination of factors relating to the residential real estate market in the United States and the mortgage financing practices earlier in this decade. After the bursting of the dot.com bubble of the late 1990s, the September 11th attacks, and the recession of 2001, the Federal Reserve under then-Chairman Alan Greenspan, lowered interest rates sharply and held rates down for an extended period. The aim of the monetary policy was to reflate the economy by encouraging borrowing and investment in risky assets. Residential real estate attracted a good deal of interest and investment.



Over the previous two decades, home mortgage underwriting practices had become very lax; it was easy to obtain mortgage financing to buy homes. With readily available credit, low rates, and absurdly loose lending standards, borrowed money poured into the residential real estate market. Home prices rose rapidly and steadily around the country. Wall Street's ever-imaginative financial engineers concocted new forms of securities backed by home mortgages; these securities were deemed by credit rating agencies to be of low risk. Financial institutions and investors around the world bought these exotic securities, often borrowing at low cost to buy them.

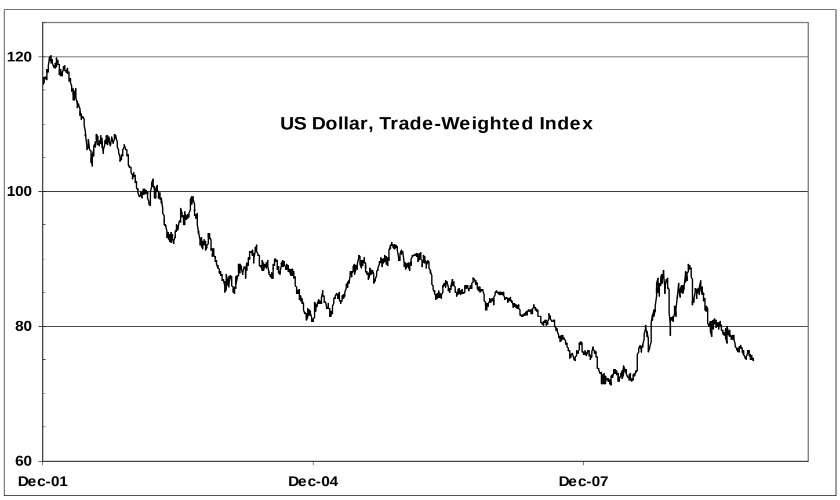
The widely-held view was that home prices, despite an unprecedented rise from the late '90s, would not suffer a year-over-year fall on a nationwide basis. Alan Greenspan took this position publicly. Respected and serious economists argued that home prices were likely to fall significantly; their warnings were given no more credence than Cassandra's. Financial incentives for banks to make mortgage loans favored the <u>quantity</u> of mortgage lending over the <u>quality</u> of loans made, so the music kept on playing--until it stopped. Housing prices peaked in 2006 and, lo and behold, began to fall. Even now, as 2009 comes to an end, home prices have barely begun to rise. As home prices fell, many homeowners found their mortgage debt to be greater than the market value of their homes. As night follows day, mortgage delinquencies and foreclosures rose, followed by further house price declines. Holders of trillions in mortgage-backed securities began to suffer losses. The losses impaired the financial health of banks, investment funds, and even small countries like Hungary, Iceland and Ireland that owned these investments.

The US dollar interrupted its six-year decline during the worst of the crisis. The dollar and US Treasury bonds were seen to be safe havens as the financial system teetered.

As investors began to have confidence in the actions by the Treasury and the Fed, foreign currencies began to appreciate again against the dollar.

B. Evolution of the crisis. The drama unfolded in fits and starts, beginning in the summer of 2007 with the collapse of two large Bear Stearns hedge funds. As 2008 began, major banks began to report multi-billion dollar losses from their own portfolios of mortgage investments. In March 2008, Bear Stearns failed. The Federal Reserve and the Treasury Department stepped in to encourage (and to finance) the acquisition of Bear (the fifth largest US investment bank) by JP Morgan Chase. In the summer, the government effectively nationalized Fannie Mae and Freddie Mac, the two private, government-sponsored entities that bought mortgage-related securities. To prevent the collapse of the giant insurer AIG, which had mortgage-related obligations in the scores of billions, the government loaned it $80 billion, an amount that proved to be just the first-round of public support for AIG. In September 2008, Lehman Brothers failed. In emergency meetings over a tense period of days, the New York Federal Reserve Bank (then headed by Timothy Geithner) and the Treasury Department unsuccessfully sought to find a buyer for Lehman, the nation's fourth largest investment bank.

Lehman's bankruptcy created chaos among large banks and investment banks around the world that had contractual arrangements with Lehman. It raised the specter of the collapse of the financial system. It appeared that a number of the biggest US banks and investment banks, including Citigroup, Merrill Lynch, Wachovia and others, might have suffered losses so great as to render them insolvent.



C. Response by the Policy Makers. Well before Lehman's collapse, the world's major central banks and governments had been closely involved in the growing crisis. Suddenly, however, with financial markets collapsing and fears of bank failures rising, the Fed and the Treasury Department began a series of actions, many continuing today, designed to stabilize the system and to provide capital to the banks. The Fed and the Treasury took the view that financial collapse must be averted at all costs; the consequences of failure were thought to be a world-wide economic depression and severe deflation.

What unfolded was a stream of new programs to support the tottering capital structures of formerly mighty banks and to maintain the functioning of key credit and capital markets. The Fed and Treasury directly injected capital into various institutions, generally involving tens and hundreds of billions of dollars. Perhaps of greater significance was the extension of credit guarantees by the Fed and the Treasury. As 2008 ended, major banks were permitted to raise capital by issuing debt guaranteed by the full faith and credit of the United States. When 2008 began, the Federal Reserve held assets of about $800 billion, almost all of it in US Treasury notes and bonds. In the months after Lehman's collapse, the Fed's assets nearly tripled to more than $2 trillion, as it loaned money to banks, secured by the very mortgage-backed securities that were causing such havoc. In effect, the Treasury and the Fed took upon the public's balance sheet enormous quantities of impaired mortgage-related assets and provided banks with high-quality assets to replace the toxic assets.

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D. Public Ownership of the Banking Industry. The Federal Reserve and the administration's policy makers made another very consequential decision as the crisis deepened:

in addition to providing financial and credit support (effectively limited only by the resources of the United States), it was determined that the United States would not take majority ownership of large banks. The Bush administration in its last months was consistent about this; Congress was consistent about this; the Federal Reserve was consistent about this; the Obama administration, when it took office, remains consistent about this. In exchange for contributing hundreds of billions of direct capital and for granting the credit of the United States to banks issuing debt to the public, the Treasury and the Fed accepted small equity shareholdings, quite dodgy packages of sub-prime, mortgaged-backed securities, and warrants and other securities convertible into small equity stakes in these institutions. Banks and other private investment institutions made reckless investments that destroyed their capital bases and imperiled the world's economies. The Treasury and the Fed extended the nation's public resources to make up these losses, but, for political and ideological reasons, refused to take ownership of the banks. (There are individual exceptions to this general pattern: the United States is now the majority shareholder of AIG, for example.)

The large increase in profits of some major banks and expectations for major bonuses for many bankers has created a real backlash of political anger. If bankers caused the problems that have put so many out of jobs and homes, how can million dollar bonuses be justified?

Anger against policy makers for favoring banks and bankers makes it much more difficult politically for the federal government to enact necessary economic stimulus.

E. Effects on Financial Markets. In the month's after Lehman's collapse, through the end of the Bush administration and well into Obama's, the Fed, the Treasury Department, and Congress initiated and expanded the many and varied programs to support the financial system. For six months after the Lehman bankruptcy, financial markets were in utter turmoil. Virtually all investment assets plunged in value. (Essentially only the dollar and US Treasury bills, notes and bonds gained in value. These were the only safe havens.) There were considerable doubts about the likelihood of success of efforts by governments and central banks to forestall disaster.

The low point in major financial markets was in March. In the months that followed, came the realization that the resources of the central banks and the rich countries were, indeed, sufficient to prevent the financial system collapse. Market participants became convinced of the resolve of policy makers to restore the functioning to banking and credit markets. Investment assets had been priced for Armageddon, as the saying was, in the winter. As confidence returned, stock, bond and commodity prices rose to levels consistent with the state of the world's economy, that is, with a very serious recession. As investors absorbed the significance of the Fed's resolve to maintain exceptionally stimulative monetary conditions for an "extended period," funds have poured into risky assets and prices have risen sharply. The dollar, which appreciated in value against major currencies by 24% during the crisis, resumed its long-running decline.

The change in consumer spending and saving patterns may be a long-term effect of the housing price collapse and the recession. Americans may spend less and save more for a long time to come. Because consumer spending has been such a large part of the US economy, we may see slower growth than in previous years.

The composition of the US economy may change: with a lower value to the US dollar, US exports may rise and the industrial side of the economy may become larger.

F. Effects on the Economy. In addition to support for the banking system and the credit markets, a series of public initiatives was undertaken to provide support for the stricken economy. As prices of homes and investment assets fell, individuals in the United States changed their spending and saving practices on a dime. By the middle of this decade, US individuals were spending more than they earned. Consumers used borrowed money, often from mortgages, to fund purchases. In a short time during the crisis, the US savings rate ran from negative 2.1% of gross domestic product to positive 6.2% of GDP, a remarkable 8.3% swing to frugality. The private sector in the United States cut spending to repair balance sheets impaired by falling home prices and declines in securities portfolios. With the concomitant loss of jobs, consumer spending contracted. The corporate sector hoarded cash as well, by cutting capital spending and reducing payrolls. The demand for credit from that private sector shrank. Into this void stepped the federal government. The stimulus package enacted in the early months of this year is to provide some $700 billion in new federal spending. This $700 billion in new federal spending, stretched over more than a year, will not nearly make up for the decline in spending by people and businesses, but it is only the Federal Government that can act on this scale to restore economic growth.

The revised third quarter GDP report indicated that the economy expanded over the summer by 2.8%. However, it appears that the private sector's contribution to economic activity was essentially flat; federal stimulus spending accounted for all the economy's growth. It is quite likely that without significant emergency federal spending, the economy would shrink further into deep recession with terrible human consequences. Thus, although the collapse of the banking and financial system appears to have been averted by extraordinary actions by the Fed and the government, the real economy is still in very grim condition. We are a long way from self-sustaining economic growth.

The Fed's extraordinarily stimulative monetary policy provides real support for financial markets. Although the real economy remains quite weak, financial market conditions are strong.

G. Political Effects. Bank profits in the last months have been very strong, flowing from two sources: Trading profits have benefited from consistent and large price changes in many tradable assets. Additionally, banks have used funds borrowed from the Fed (at essentially no cost) to purchase higher yielding securities. Given the very low cost of funds and the significant leverage banks can employ, their profits have been high. In effect, banks' high profits meet one of the explicit goals of Fed and Treasury support for banks, namely the rebuilding of bank balance sheets after the losses of the last two years.

Of course, the principal public function of banks--and a principal reason for their rescue in the last year--is their lending to private businesses. Banks' provision of capital to the nation's private businesses permits businesses to maintain and develop their activities. The unhappy fact, however, is that bank lending is far lower now than it was before the financial crisis arose. Underwriting standards are much more rigorous than previously; it is far tougher for all but the biggest and financially strongest business to obtain financing from banks. It is also the case that loan demand is lower now in the recession, than during the mid-decade period of expansion. It is unclear whether it is tighter lending standards or reduced loan demand that is the primary cause of the decline in lending. The result, however, is that bank capital is being used less for lending and more for trading and leveraged investment in high yielding securities.

The effects of rising bank profits in our still-private banking system and high compensation and bonuses to bankers during this grinding recession, with its growing ranks of jobless and homeless, are politically toxic. The acute financial crisis may be over, but the political consequences of the decision to rescue the banks without taking control of them may give rise to a different, but serious crisis.

H. What lies ahead? The resolve, imagination and resources of the central banks and governments will probably suffice to recapitalize the banks. The credit markets, which had essentially stopped functioning in September 2008, have come back to life; their crisis appears to be over. Stock markets have recovered from the depths of the late winter, encouraged by the exceptionally favorable monetary conditions provided by the Federal Reserve Board. Because the Fed has promised to maintain these very accommodative monetary conditions, investment assets will have support for an extended period. The dollar will probably continue to decline against foreign currencies, another consequence of the Fed's monetary policy and the administration's efforts to stimulate the economy.

The timing of the economy's recovery to sustainable growth in the private sector, of the resumption of strong employment growth, and of stabilization of housing prices are all quite uncertain. Because tax revenues have fallen while federal spending has been rising, federal deficits have grown to hitherto unimagined levels. When the private sector grows and borrows once again, federal borrowing must fall, or rising interest rates and inflation will be at hand. Timely action by public officials has averted the collapse of the banking and financial system, but complex problems are still before us. Their resolution is unclear.

Future letters will discuss these matters further.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

October 5, 2009

Roth Conversion and Other Matters

Changes to rules relating to Roth IRAs present an opportunity for many investors in 2010. This letter provides a preliminary discussion of this.

Congress has created a very interesting opportunity for investors, the subject of this letter. In 2010, one can convert traditional IRAs and other qualified retirement plans (like 401Ks, SEP-IRAs, and profit-sharing plans) into Roth IRAs without the limitation on the income of the owner of those plans that has previously existed. This is necessarily a somewhat dry subject, but it is worth consideration: it presents us with a very significant opportunity to increase the after-tax value of our investments in IRAs and other plans.

The background. In a traditional IRA (for convenience, I generally refer to other forms of qualified plans with traditional IRAs in this letter), one makes contributions with pre-tax dollars. The investment earnings within traditional IRAs are not taxed until withdrawal, at which time IRA distributions are taxed as ordinary income. In a Roth IRA, one contributes funds on which one has already paid taxes. So long as funds from a Roth are not withdrawn for 5 years, distributions from the Roth are not taxed. Thus, investment appreciation within a Roth IRA is never taxed, unlike the situation with traditional IRAs, for which taxes on investment gains are merely deferred until withdrawal. Despite their attractions, Roth IRAs have not been widely used, because conversions of traditional IRAs to Roths or contributions to them have been available only to those with modified adjusted gross incomes of $100,000 or less. The key feature of this new legislation is that the income limitation is dropped: anyone can convert a traditional IRA to a Roth, without respect to income.

The complicating factor is that, upon conversion of a traditional IRA to a Roth, one must pay the taxes on the sum converted. However, the legislation provides that for conversions in 2010, one can recognize half the income in 2011 and the other half in 2012. Thus, to determine whether it is advantageous to convert one's traditional IRA to a Roth, one needs to weigh the effect of the taxes to be paid in the next two years against the likely tax savings on the future investment income in the Roth. We are preparing a template to analyze the various factors and apply them to individuals' financial situations. We have looked at a couple of websites with tools to make the calculations. I expect there may be some good ones out there, and we would appreciate hearing of any you may find.

By

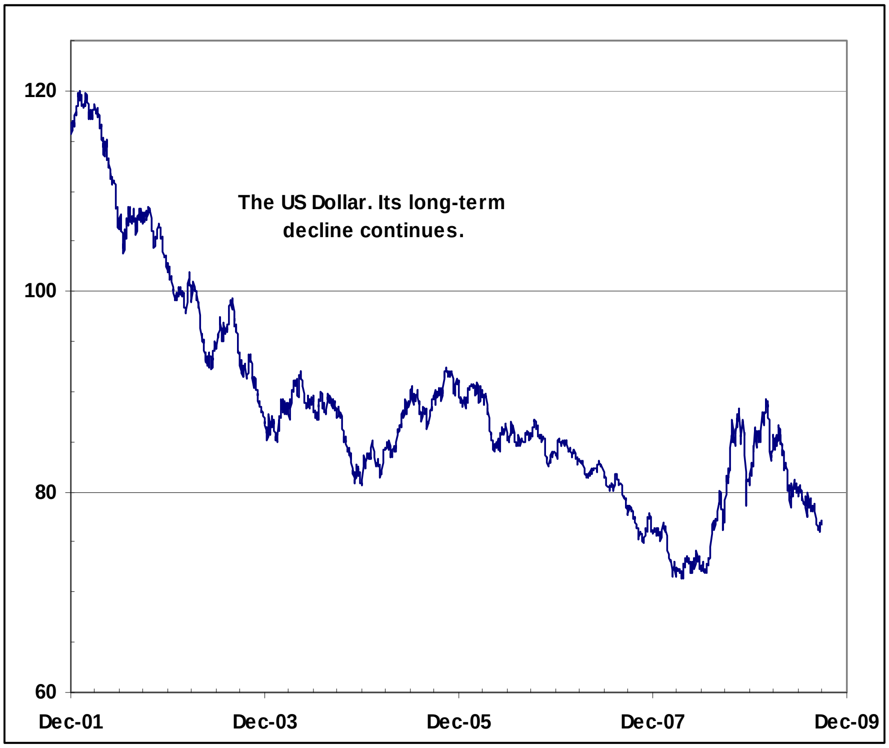
Jack Mayberry

We will write more about this. For now, note that it will probably be very advantageous for many people to make the conversion to Roth IRAs. The opportunity to make the conversion begins in January and continues until the end of 2010. Thus, we have 14 months to consider this before we need to act, but it behooves to begin thinking about this now.

The US dollar has resumed its decline against other foreign currencies. The decline will continue. To our investments in major foreign currencies like the euro, we recently added a position in bonds issued by governments and companies in developing economies of Asia and Latin America.

Schwab and electronic trade confirmations. For some time, Schwab had offered its customers the option to receive statements and trade confirmations electronically by email. In exchange, the commissions charged by Schwab are lower. Many of Core's clients have taken advantage of this; some have not. Schwab will soon be sending notice to those still receiving paper confirms and statements to switch to the electronic one. This seems to us to be a good deal.

The dollar and emerging market bonds. The third quarter that just ended was, as you know, quite favorable for our investments, building on the recovery that began in March. In the last couple of weeks, economic reports have been less favorable than those of the recent months. Given the very extensive rally, markets are somewhat vulnerable. We retain large holdings in US bonds; we might well sell some of those, if we do have a bout of stock market selling, so as to buy more equities. We continue to be fairly bullish about the long-term prospects for equities, particularly those of the emerging economies of Latin America and Asia.



We recently made some changes in our portfolios of foreign currencies and bonds. The dollar's long-term decline was interrupted in the financial crisis last year: The dollar (and US treasury bonds) rallied very sharply from July through March, as virtually every other investment asset in the world plunged in value. Since March, as it has become clear that the world is not coming to an end, the dollar has resumed its decline, as the nearby graph shows, while other investment assets have begun to recover from their losses.

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Having sold our previous foreign currency positions in the spring and summer of 2008, we began to buy currencies again in March of this year as the crisis was subsiding. We purchased euros, the Canadian and Australian dollars, and the British pound. (We invest in these via exchange-traded funds, which are, in effect, money market funds denominated in those currencies.) We recently sold the British pound position and invested in a closed-end fund that holds bonds issued by governments and companies in the developing world. Our expectation is that the growing financial strength and foreign reserves of developing countries will cause their currencies to rise in value against the dollar.

This rationale is related to that of our equity investments in the emerging economies, which we have written about frequently in the last several years, including in the letter from two weeks ago. The developing economies across Asia and Latin America are increasing their share of the world's economic pie. At the same time, their finances are improving markedly. Their stocks, their bonds, and their currencies are increasing in value. With this recent investment, we have continued our process of increasing our investments in these dynamic investment markets. This investment will increase in dollar terms as the US dollar weakens; it pays a large dividend as it collects interest on the underlying bonds in the portfolio.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

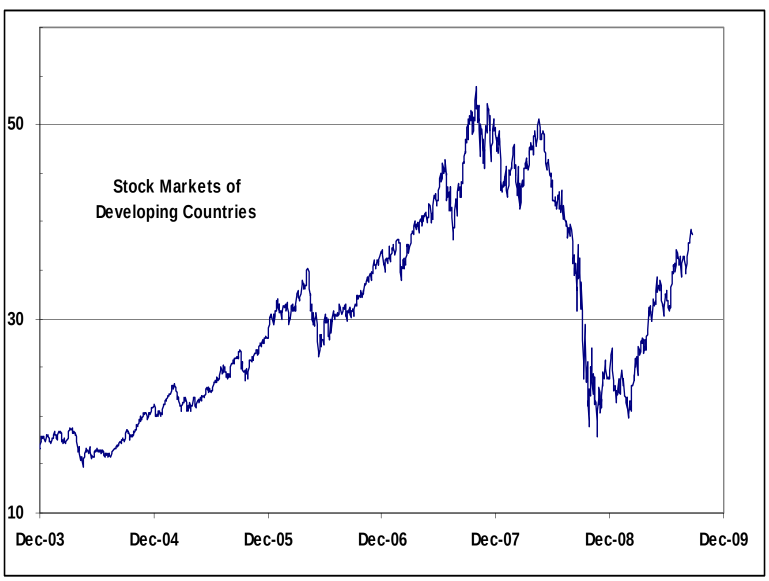
September 22, 2009

The View Ahead

What will unfold in the world's economies and in financial markets over the next five to ten years? Rather than considering the recent past and the prospects for the period just ahead, let us assume that the crisis of the last eighteen months is over and take a look a bit further down the road.

Stock markets of developing countries grew strongly in the early part of this decade. Economic conditions and the flow of investment capital are likely to drive them far higher in the coming decade.

Two significant economic trends have been unfolding in recent decades: the growth of developing economies, especially in Asia, and the relentless expansion of credit in the United States. Economic growth in China, India, Brazil and many other developing countries has been accompanied by what may loosely be called 'globalization', including freer flow of goods and capital around the world and the opening up of financial markets in developing countries. Rapid credit growth in the United States is a phenomenon that began in the 1980s. Since then and until last year, Americans took on more and more debt in relation to America's economic activity. The collapse of home prices since 2006 caused massive defaults on this debt and triggered a move by Americans--individuals and companies--to save rather than to borrow.



There is not room in this letter to discuss these phenomena more fully, but the interplay of more saving and less debt by Americans, with continuing strong growth in developing countries, suggests that financial markets in developing countries will attract far more capital in coming years. As capital finds its way into stock markets in these countries, the prices of investible assets in those countries will rise. In short, it seems likely to me that the growing economies of the developing world will prove to be very successful investments in the next decade.

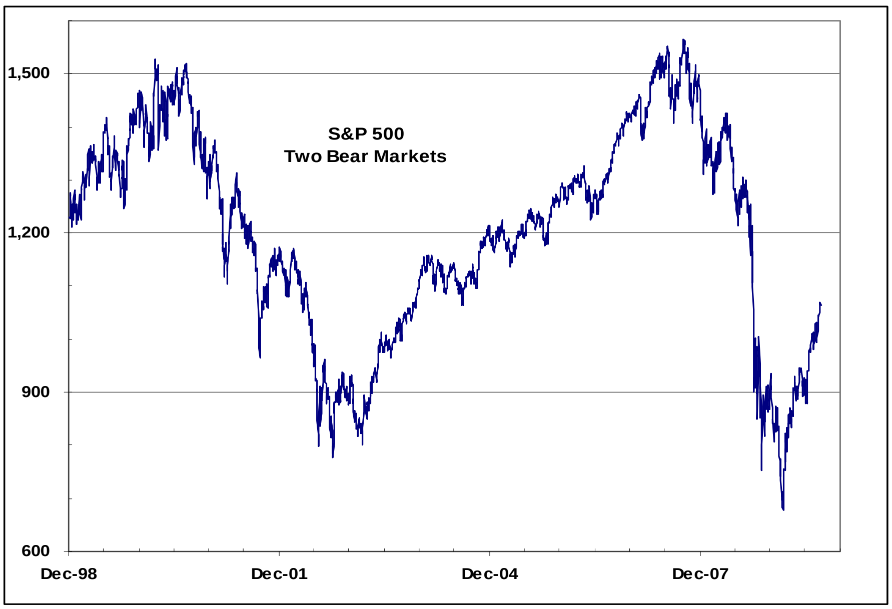
America's economy surely will grow in coming years, as will the US stock market. The same applies to the economies and the financial markets of the western European countries. But it seems a near certainty that America's slice of the world's economic pie will shrink as economies of developing countries grow faster. Core's clients have had meaningful investments in developing countries for several years; my expectation is that we will increase the portion of our clients' capital allocated to emerging markets in the coming months and years.

By

Jack Mayberry

Take China as an example: a significant amount of its growth over the last decade has come from investment in its roads, bridges, railways, airports, factories, and the like. (We used to call this public works, now the favored locution is infrastructure investment.) Export activities have also grown substantially. It is probable that infrastructure investment and exports will continue to be strong, but to these will be added growing spending by Chinese consumers. Growing wealth and spending by consumers in the developing world will probably itself be another force to drive stock markets in these countries higher.

The problems that unfolded in the wrenching crises of the last eighteen months are by no means fully (or satisfactorily) resolved, but the tools employed by central banks and governments tend to produce outcomes we can already observe, that is, rising prices of stocks and other risk assets. As the financial crisis subsides, the markets are hinting, it seems to me, at what lies ahead. Massive credit support and direct infusions of capital by the government into banks and other failing industries, huge government spending to stimulate economic activity, zero percent interest rates on short-term deposits, direct purchases of securities by the Federal Reserve and other central banks all are directed to arrest the deflationary spiral. In effect, the Fed and the government seek to forestall the impulse by the private sector to save: their policies encourage a new round of credit creation.



Central bank and government actions are driving investors away from safe investments--money market funds yield next to nothing--and into risky assets like corporate bonds and stocks. The Fed and other central banks assure us that these policies will continue for a long time. This is a very positive force for investment markets.

Thus, we have in place the ingredients for very large investment gains in the rapidly growing economies of Asia and Latin America. Government policies impel investment toward equities and other risky assets. Economic growth will be strongest in the developing economies; dynamic growth in those countries will be a magnet for investment from the United States and elsewhere. Fine investment returns from our investments abroad seem quite likely.

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A caveat is in order. My notions about economic growth and the movements of investment capital over the next period of years are reasonable, I submit. Experience teaches me that having an informed and rational point of view about the future is useful in investing. But predictions are quite perilous. We are by no means making a set of investments in 2009, then heading off to the beach for the next decade. We remain alert to risks, political and financial; we are prepared to act quickly in response to problems that will certainly arise.

It is certainly appropriate--after this fantastically dramatic banking and financial system crises of the last eighteen months--to look ahead calmly and think about the future. At present, the crises seem to be resolving themselves, although in a muddled and quite imperfect way. And, at present, the future has some bright aspects. I have tried to outline them in this letter; we will work to realize their benefits.

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

August 21, 2009

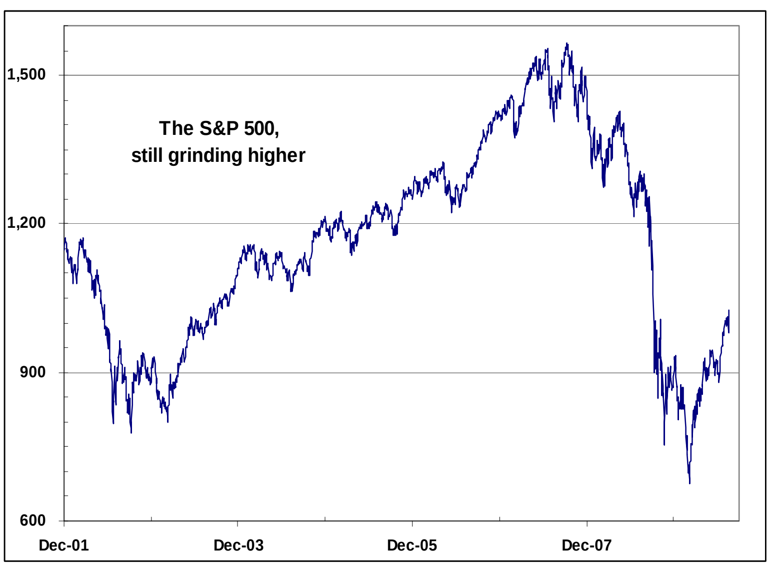
An Uncertain Juncture for the Economy and the Markets

The financial markets have continued to rally, even as some of the 'green shoots' appear to be withering.

Economic growth may turn positive in this third quarter, but a strong sustained economic recovery seems unlikely to be commencing now. Given somewhat high prices in the stock market and other risky investment assets, what are the risks?

Since my letter from last month, the stock market has staged a big rally. The S&P 500 stands about 13% higher now than when I last wrote. Other markets in which we invest have also rallied, and Core's clients' accounts have all appreciated well. However, the economic news has shown neither a corresponding increase in economic activity nor the prospect for significantly higher corporate profits. So where does this leave the investment markets? What are the prospects for further appreciation?

The recession may be coming to an end. It seems likely that businesses will increase production in coming months, having drawn down inventories at an exceptional rate since last autumn. New orders are rising at a rate faster than production, suggesting that production will increase, providing a lift to the economy as a whole. And the Federal Reserve assures us that it will continue for a long period its extraordinary policies designed to reflate and to stimulate the economy.



Recall, however, that consumer spending has, in recent years, accounted for about 70 percent of America's economic activity. Real (i.e., inflation-adjusted) personal spending fell again in the most recent month. People are saving far more than in recent years, in order to rebuild personal balance sheets, damaged by falling income (job losses and pay cuts) and falling asset prices (houses and securities portfolios). Until businesses begin hiring in earnest again and until house prices begin to increase, it is likely that consumer spending will be weak. Unfortunately, the job market will most likely be very poor for another year, perhaps for longer. There is some indication that home prices are not falling as precipitously as in the last year, but it is difficult to imagine any significant price appreciation in the housing market in the next year. Indeed, with prices as low as they are now, mortgage defaults and foreclosures are still rising, putting a further obstacle in the way of robust consumer spending.

By

Jack Mayberry

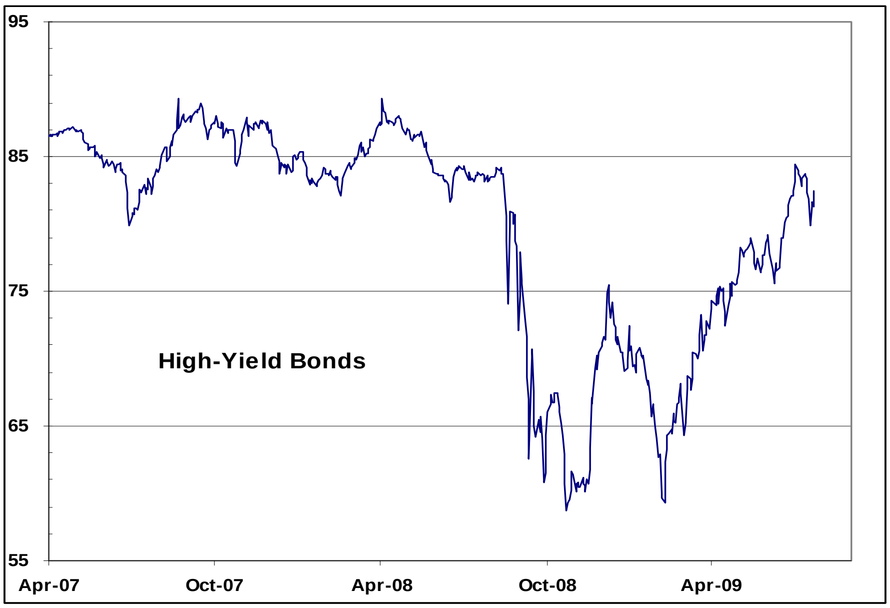
Because of these factors and others--e.g., does the "cash for clunkers" program pull automobile spending forward and rob from purchases that would have been made later this year or next?--there is a risk that economic growth that may be registered in this third quarter or next will give way to a further contraction in economic activity in 2010. This is the "W" scenario, i.e., reces-

High-yield bonds, those issued by financially weak companies, always do poorly in recessions, because of the heightened risk of default.

In the autumn and winter just passed, prices fell to levels consistent with corporate defaults unimaginable except in a real depression. We invested in these bonds then, and recently sold part of our position after the tremendous rally since March.

sion, brief growth spurt now or soon, then back to recession in 2010, before the real recovery begins.

Effect on investment markets. Direct, short-term correlations between the broad economy and the investment markets are not the rule, as you know, but there is more than a nodding relationship between the markets and the economy. Thus, given a very significant rally in stocks and other assets since March, are the markets vulnerable to selling if the economy falters? I believe so. Market conditions in March suggested that the risk of the collapse of the world's banking system was high. It now appears that the so-called Armageddon risk is off the table. Timely action by the central banks and by governments in the last twelve months has prevented the collapse of major banks and of the financial system as a whole. It is therefore entirely reasonable that stocks, corporate bonds, commodities and other asset prices are now higher than at their panic lows of March. But it is also quite plausible to look at prices now prevailing in the US stock market (and others) and to conclude that they predict a sturdy and sustained period of economic growth. However, the recovery may not be sturdy and sustained, but shaky and fleeting instead.



Last week, we sold a portion of the position in high-yield bonds that we purchased several months ago. At the time of our initial purchases, these bonds were trading at extraordinarily low prices, suggesting depression-like levels of corporate bankruptcies. High-yield bonds have rallied hugely in recent months and seem over-priced now. We are considering reducing other positions, the prices for which are now quite high, and investing in safer and cheaper securities.

Short-term caution, long-term confidence. I do not wish to paint an overly negative picture of the investment scene. There are many factors that suggest that we are in early stages of a prolonged period of economic improvement and rising markets. The policies of the Federal Reserve and the US government are designed to stimulate economic growth, provide support for the banking system and encourage investment. The scale of these actions is enormous and utterly without precedent. Indeed, the Fed's exceptionally powerful policy actions are exceedingly favorable to investment markets. The perception, which the Fed encourages, that these accommodative policies will remain in effect for a long time keeps markets marching higher. Other major countries have undertaken similar policies. Economic growth is already strong in China and other East Asian countries. We may well see a set of further policy successes, stronger economic growth than now seems likely, and sustained appreciation in investment assets.

My sense is that even if we do have another slide in the markets in coming months, investment assets will probably appreciate over the next two to four years to levels well above those that currently prevail. We are in the early stages of what will prove to be a very fruitful period for our style of investing. In short, caution now; more aggressive investing later.

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

July 14, 2009

Economic Weakness Persists

Economic growth may not begin soon and will likely be tepid for a long time.

Despite poor economic prospects, investment markets are likely to be well higher in a year and two than now.

A terrible employment report for June, in which job losses were far greater than expected, may mark a significant sign post in our long financial crisis and economic recession. There had been hopeful signs that the recession was coming to an end and that the rate of economic decline was slowing. But the jobs report and other recent economic reports suggest that the recession is still severe. Economic recovery may not begin in this third quarter, as has been expected by many. It is almost certain that the recovery in the US, when it does begin, will be weak. Creation of new jobs and a decline in the unemployment rate may be quite far off. If job losses continue, it is likely that mortgage foreclosures will continue and housing prices will fall further. It is hard to envision strong consumer spending and an improving housing market when more people are losing jobs and wage growth is stagnant.

In Saturday's Financial Times is an interview with Lawrence Summers, the former Treasury Secretary and now the director of the Obama administration's National Economic Council. Of the recession, Summers said:

"I don't think the worst is over ... It's very likely that more jobs will be lost. It would not be surprising if GDP has not yet reached its low. What does appear to be true is that the sense of panic in the markets and freefall in the economy has subsided and one does not have the sense of a situation as out of control as a few months ago."

This comment suggests that (1) the risk of collapse of the global banking and financial is far less than last autumn and winter, (2) we appear not to face an economic *depression*, but (3) we still face the consequences and risks of our severe *recession*. Quite appropriately, there is discussion about the need for another package of spending to stimulate the economy.

By

Jack Mayberry

As an investment matter, things are more clear and, indeed, more promising. The strong, three-month rally in stocks, commodities and other 'reflation' assets ended in June. That rally began in March, when fears of collapse were acute. At that time, asset prices reflected the fears of banking collapse and global economic depression. As those fears receded, prices of investment assets improved. Now, prices for bonds, for stocks, for commodities, and for commercial real estate reflect, it seems to me, the severe economic recession in which we find ourselves. Prices do not yet reflect economic recovery, weak or strong, that surely lies ahead. Hence, it is quite reasonable to expect that prices for all these investment assets will be higher in a year and more than they are now.

Bear markets, whether 'normal' or very severe--no bonus points for guessing which this one is--are characterized by a sequence of sell offs and rallies. In this bear market that began in the autumn of 2007, we have had a series of lows, each lower than the previous one, in January, March, July, September, October and November of 2008, then in early March 2009. It usually happens, and it probably will again in coming months, that the ultimate low price for the bear market (now March 9, 2009 at 666 on the S&P 500) will be 'tested' again. If this upcoming sell off does not reach the previous low (our 666), then it will be a fair bet that the bear market is over, and a new bull market is underway.

Given the forceful actions by the Federal Reserve Board and the Treasury, their determination to prevent collapse of the system, and the recent ability of banks to raise large amounts of capital in the private markets, it seems likely that the 'Armageddon low' (if we can call it that) in early March really will prove to be the low point for the bear market. The banking and financial system will not fail. It seems likely, in the coming months, that stocks, low-grade corporate bonds, commodities and foreign currencies will fall back toward the March lows. When and if these various investment assets 'pass the test' and remain at higher levels than their March lows, we may, with some confidence, invest rather aggressively and buy the 'reflation' assets. This is our plan, and we expect a very favorable outcome.

The chart on the front page shows the course of the 2000 to 2002 bear market, and this one that began near the end of 2007. This bear market appears to be coming to an end.

Allow me to remark that this is 'our plan' now, and it is based on assumptions outlined above. Predictions about the economy and the financial markets are easy to make, but the outcomes are not certain to be realized in the ways predicted. We have our eyes open to reality as it unfolds and we will certainly adapt our plans to what really happens.

Housekeeping items. As you may imagine, Schwab has a business division dedicated to investment advisors like Core and their clients. We deal with Schwab on a daily basis (usually several times a day) on a range of issues; a team of people is assigned to deal with Core. Schwab also has a group, called Schwab Alliance, for the clients of investment managers. If you wish to contact Schwab directly, rather than through us, we suggest that you call this group at 800 515 2157, or by the internet www.SchwabAlliance.com. We suggest, however, that it will probably be more efficient for you to call or email us, and let us intervene with Schwab on your behalf. We can obtain quick and reliable answers and, of course, we can help you accomplish what you are seeking to do with Schwab. From time to time, we hear from clients about problems they have when they contact Schwab directly through an Schwab's regular 800 number for 'retail' clients. It is not a knock on Schwab to remark that not all of these exchanges are satisfactory to those who call in. Rather than practicing your skills with call centers, we suggest you enlist our help. You pay us to manage your capital; you also are paying us for our help in administrative matters relating to your investment accounts. Please call on us, if you wish.

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On another matter, Schwab recently sent a notice to some of Core's clients about a security held in accounts Core manages, called the Eaton Vance Tax-Managed Global Income fund, symbol etg. Schwab told its customers who hold this in a margin account that etg is no longer 'marginable. This is not relevant to us and it does not bear on the investment merits of this security. We almost never use margin, that is, the borrowing of money to make investments. When we do it, we only do so after a direct conversation with the individual account owner.

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

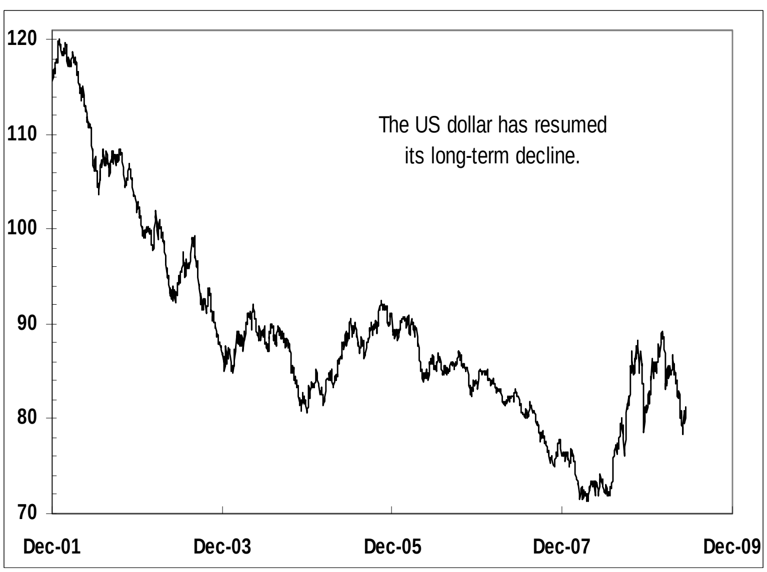
June 17, 2009

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.

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

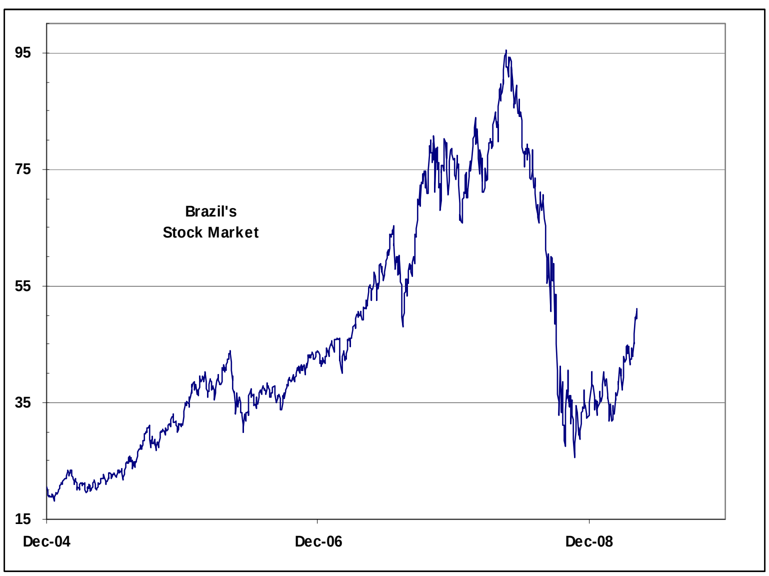
May 11, 2009

Actions and Confidence

Stabilizing the banking system and recapitalizing the banks have been the primary work of the Fed and the Treasury for many months.
The process is a mix of real actions by the Fed and the Treasury, and of intangible efforts to buy time and raise confidence.

The stock market has moved ahead steadily since early March, suggesting that the financial system and the economy are on the mend--or at least in anticipation that things will improve in time. The federal government's reports on the ability of the 19 largest banks to survive losses that may lie ahead--the 'stress tests'--were leaked to the press over the last two weeks, then released on Thursday last week. The stress tests purport to show that much more bank capital is needed, but the perception seems to be that the combination of private capital and anticipated earnings can supply that capital. Markets took comfort in this view and continued to rise.

As March began, there was palpable fear that the banking system was insolvent and that the actions of the Treasury and the Fed would be insufficient to stabilize the system. At least in the short run, it appears that those fears were overdone. The intense selling came to an end; confidence in Treasury Secretary Geithner grew; fear was supplanted by optimism. The sectors of the stock markets that had suffered the biggest losses, including bank stocks, began to rally very sharply. Fixed income markets improved markedly, especially US corporate bonds, which began to trade at more normal levels in relation to government bonds. The dollar, which gained sharply in value as the crisis worsened, began to decline again against foreign currencies, another sign that markets are functioning more 'normally'.



In the months after the shocking collapse of Lehman Brothers, and the effective ends of Fannie Mae, Freddie Mac, and AIG as private firms, the world's financial system was very close to complete failure. It was only the large central banks (especially the Federal Reserve) and national governments (especially our Treasury Department) that had sufficient resources to rescue the financial systems and to keep economies from severe recession or worse. The rescue attempt was approached from two quite different levels: fixing the real-world problems and restoring confidence. The first level involved deciding how to provide capital where it was needed, deciding whether to preserve the banks as private companies or to 'nationalize' them, and choosing which firms should survive and which should be allowed to fail. These decisions are enormously complex; many were required to be made under exceptional time pressure. In the fullness of time, we will be able to judge which were the good decisions and which were poor.

By

Jack Mayberry

Confidence Building. The second category of rescue involves the intangible matter of restoring confidence that the system would survive and would be repaired. Restoration of confidence is fantastically important. A complex global banking and credit system can work only if its participants can trust that it does work. The collapse in investment markets between September and March shows what happens when trust and confidence are eroded. Awkwardly enough, America had a presidential election in November. The outgoing Bush administration did not have the authority in the months before January 20 to forge long-term solutions and to rebuild shattered confidence. It took time for the new Obama administration to take on the task effectively.

It seems to me that improvements in equity and fixed-income markets since the early March lows flow from reasonably successful work by the new administration in restoring confidence, my second category rescue. This is not to discount the very significant and helpful actions by the Federal Reserve, nor to ignore the specifics of the banking rescue and reform actions by Treasury. But at best the repair of banks' balance sheets is a long-term process; it is clear that there are huge losses that banks will incur in the coming year and more. As banks earn money and raise capital in coming months, we will see whether capital is built up more quickly than it is lost.

Brazil, China, and other developing economies have been largely untouched by the banking problems in America and Europe. We have made investments in these markets recently.

For now, though, the confidence-building efforts of the Obama administration and the Federal Reserve are working. With luck, the real economy developments will be helped by the various emergency actions of the last six months and more. If so, the recession will come to an end, the world will have a functioning credit and banking system, and investment markets will recover. It seems highly doubtful to me that these improvements will proceed in a straight line. Instead, the more likely course will be the roller coaster ride of fear and hope, each punctuated by very sharp swings in asset prices.

Core's investments. Since the beginning of March, we have moved in measured steps into various sectors of financial markets now emerging from intensive care. We have reduced cash positions in accounts by 35%, added 20% to corporate bond positions, including initial investments in high-yield bonds, took a 6% position in foreign currencies, 2% in gold, and increased equity investments by 5%. (Note that these are aggregate figures for all of Core's accounts. As always, there is variation among individual accounts.)

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Core has made its investments over these last two months on these assumptions: First, within twelve months, economies, including America's, will be recovering from the recession. Second, there is meaningful risk that banks will lose enough from commercial real estate, student loans, auto loans, credit card loans, and further losses from US housing to renew doubts about the banks' solvency. Third, developing economies, especially China and Brazil, are sufficiently divorced from America's banking problems as to be able to grow strongly. Fourth, US corporate bond markets offer exceptional value, without much risk and with good return prospects. Fifth, the Fed's expansion of the asset side of its balance sheet and the federal governments needed but risky deficit spending create inflation risk and US dollar depreciation opportunity.

In our view, the environment remains risky, but some areas--US corporate bonds (including low-grade bonds now), equities in and around China and Brazil, and some inflation hedges--present opportunity without too much risk. Your capital resides there.

CORE Comments

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

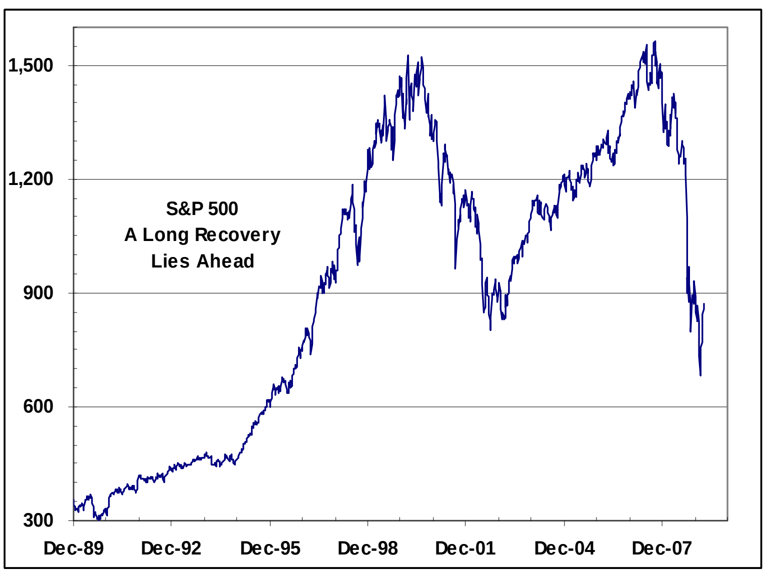
April 19, 2009

One Step at a Time

Although the economy will remain weak for a long time, financial markets are functioning more rationally now. We have begun a series of reflation-related investments.

Slowly, ever so slowly, things improve. The six-weeks long stock rally means something, but it is only one piece of the puzzle. More significant are improvements in fixed-income markets, in which the 'spreads'--i.e, the differences between yields of corporate bonds and treasuries--are narrowing. As price differences between treasuries and various types of corporate bonds narrow, we get a sense of progress toward "normal" pricing of investment assets. Although the economy continues in a terrible state, prices in investment markets suggest that the world's banking and credit systems will not utterly fail.

In the autumn, after the collapse of Lehman Brothers and the (now-questioned) rescue of AIG, there was well-founded fear that financial systems were unraveling. Mr. Bernanke, our Federal Reserve Board chairman, and Mr. Paulson, our then-Treasury Secretary, recognized the risk. So did our incoming President and his advisors. They sprang into action, as did a number of the world's other important central banks and finance ministries. Government and central bank actions have been designed to keep the banking and credit system functioning, or to stimulate economic activity, or both. The Fed has expanded its balance sheet enormously and become America's banker in ways necessary, but heretofore unimagined. To make up for the collapse of private banking and lending functions, the Fed buys commercial paper, extends its credit to private investment funds, and engages in other novel and utterly unprecedented banking activities.



In my view the Fed's actions and those proposed by the Treasury are needed and helpful. Because of the severity of the economic and financial system problems, many actions are indeed radical. Decisions have been made and policies undertaken under extreme pressures. Although some policies will be seen, in retrospect, to have been flawed and damaging, we are being well served by the activist approach. Doing little or nothing runs the risk of a much worse recession and of the collapse of the system.

By

Jack Mayberry

Investments. Core's investments since the autumn meltdown have been guided by two main views: First, the system ultimately will work and the economy will recover. Second, the crisis is not yet over. Thus, we are engaged in a careful balancing process: We are investing in assets that appear to be relatively safe and to offer good returns as the markets return to normal, while we husband large cash and bond reserves against further market turmoil.

Problems in the banking and credit system are a long way from resolution. Mounting job losses will continue to hurt the economy and housing prices, and to threaten the solvency of banks.

These factors argue strongly for very cautious investing. We hold large investments in high-grade bonds, but only very small investments in riskier assets.

Our investing in high-grade US bonds was the first step; we began it in December. We sense the beginning of the dollar's decline--which is, for better or for worse, also a return to "normalcy". We have begun to invest in Euros and we intend to take a position in the Canadian dollar. We have made small initial investments in Asian equities (specifically in Taiwan and Hong Kong) as play on China's reaccelerating growth. We made a small investment in gold, as a hedge against the dollar's decline and against the inflation risks posed by governments' economic stimulus spending. We made another small investment in large, financially strong US technology companies. (These business are hurt by the economic recession, but they do not depend on the banking system to fund their activities; in general, they have huge amounts of cash and no debt. Many industries have both problems; technology has just one and should continue to outperform stocks generally.)

We have a full set of planned future investments for the months ahead. The flow of economic reports and the markets' responses to these will teach us when the balances between risk and reward tilt in our favor for these investments. As everyone knows, the fantastic and horrible waves of selling of investment assets have offered up remarkable values; as risk subsides for these various assets, we plan to act and we expect good results.

An administrative note: We use an electronic fax service that sends faxes to Core's server and enables us to preserve pdf copies of the information you send us. We suggest that you fax information to us at 440 332 2002.

Apart from investing in the Canadian dollar, mentioned above, we intend to build a position in lower-grade corporate bonds. We are close to taking the first step in this process. The low-grade, high-yield corporate bond investment idea is related to our investments in high-grade US corporate bonds. During the calamity of last autumn, every imaginable asset declined sharply, with the exception of the US dollar, the Japanese yen, and Japanese and American government bonds. High-grade corporate bonds (e.g., bonds issued by companies like Procter & Gamble and Johnson & Johnson) fell in price because of the generalized panic selling and the fears of the ultimate financial disaster. The selling created wonderful values in these bonds: companies like these may suffer from recession, but their ability to pay interest and principal on their bonds is not at risk. We have investments in them and we are earning a good return.

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The bonds of riskier companies fell by much more in price. Their bonds are, indeed, riskier. Some companies will default in payments on their bonds and the recovery from these defaults will be less than 100 cents on the dollar. However, the market is now pricing the risk of defaults and the recovery rates at absurdly unrealistic levels. As time passes, the risk of Armageddon recedes and makes these high-yield bonds increasingly attractive. We expect soon to make an initial investment in these; we expect over time to build a reasonably large position in such bonds and we expect to earn very attractive returns from these.

The economy. A word about the economy: We read of 'green shoots' of economic recovery. Of course, it is springtime and the metaphor is readily at hand. However, we are losing jobs at the rate of 600,000 each month. Necessarily, this increases mortgage delinquencies and defaults and puts more downward pressure on home prices. The recovery process will be a long, faltering, and slow one. We can surely expect economic recovery, a functioning banking system, and appreciation in financial markets. We should not expect it too soon. Patience is still a virtue.

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

March 24, 2009

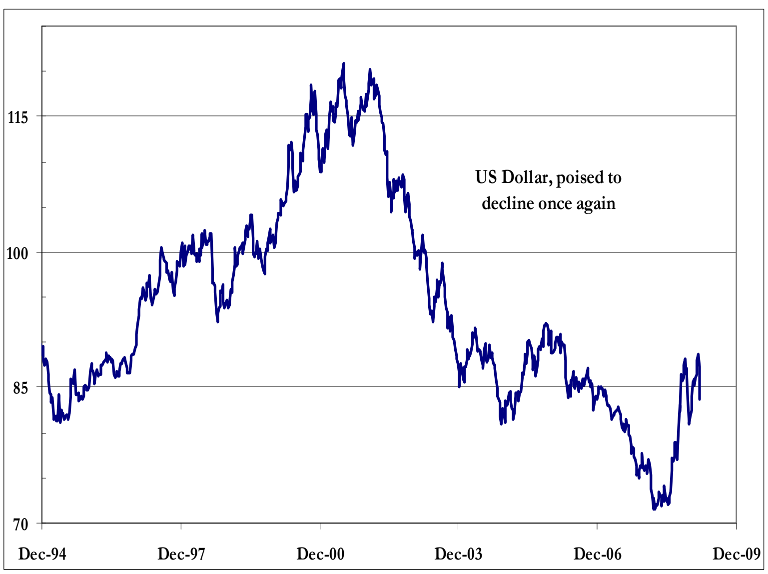
The Fed and the Treasury
Roll out Bigger Artillery

The Fed and the Treasury are acting forcefully and effectively to restore the banking system and revive the economy. Their efforts will bear fruit.

One outcome of the Fed's efforts to reflate the economy is the resumption of the dollar's long-term decline. We have begun a slow move back into foreign-currency investments.

The spirited stock market rally from its 666 low in the first week of March is welcome, but unremarkable. The distance from that low to its high Monday at 823 amounts to a rally of 24 percent. Bear markets produce sharp, swift and fleeting rallies. In November, after the (first) Citibank low, the market rallied 26 percent to its high in January. After the October 10 low, the market rallied by 24 percent in *two sessions*. The present rally, now in its third week, may carry further. As we write on Tuesday evening, this seems likely.

More remarkable than this rally was the Fed's announcement last week of the enormous expansion of its balance sheet. The Fed will purchase $300 billion of US Treasury notes and bonds in the next six months, an additional $750 billion of mortgage-backed securities, and another $100 billion of debt of Fannie Mae, Freddie Mac and other federal agencies. These actions are designed to reduce the risk of debt deflation and to spur economic growth. Monday's articulation by Treasury of its joint public-private program to aid the balance sheets of the banks burdened by holdings of impaired mortgage securities demonstrates its co-ordination with Fed actions. These acts will hasten the re-emergence of private capital for the banking system.



Their likely impact on the economy and investment markets is straightforward: They will bring closer the day of economic growth and the restoration of a functioning and reasonably capitalized banking sector. The risk of deflation remains serious. Although housing prices will decline further and the job market will worsen, the actions by Treasury and the Fed will almost certainly shorten the recession and hasten the recovery.

Reflation of the economy is now in prospect. With economic recovery will enter its attendants: dollar depreciation and the appreciation of many investment assets. Among these are low-grade bonds, equities, commodities, and commercial real estate (REITs).

By

Jack Mayberry

The ongoing efforts of the Fed and Treasury bring closer the day that marks the bottom of this dreadful economic recession, the horrific collapse of the banking sector, and the ferocious bear market in stocks and commodities. But, as it seems to us at Core, economic recovery and the bull market still lie in the future. While we are planning the investments that will prosper as things recover, we are treating this welcome rally in stocks as the opportunity to sell certain equity positions that we still retain. We fear that short-term risks remain large.

The rush into US Treasury bonds and bills by foreign and domestic investors is abating. The dollar will fall as the Fed succeeds and the crisis subsides.

The process of recovery--in the economy, in the banking system, and in investment markets---will take time, but it has begun.

The dollar. As the graph on the first page shows, the financial crisis of 2008 reversed the dollar's years-long decline and caused a tremendous rally since last summer. (One of our best, but quite invisible, investment moves last year was the closing of all of our foreign currency positions before the stampede to the dollar began. The investment action was invisible because we measure our investments in dollars. Thus, if we avoid dollar losses by closing our euro investments, for example, the losses avoided don't show up anywhere. However, if we had kept our once-large foreign currency investments, you would have seen the losses.)

For various reasons, as the crisis unfolded, demand for dollars rose enormously, as US investors (ourselves included) repatriated capital from abroad and foreign investors sought the safety of US treasury bills. These flows are reversing. In January, net foreign purchases of US treasury bills turned negative, while US investors became net buyers of foreign securities. The Fed's aggressive action to drive down interest rates on US bonds will likely strengthen these very new trends and push capital away from the dollar. We are probably in the early stages of the dollar's next move down. We made an initial foreign currency investment today by buying a small position in a euro-denominated short-term fixed-income fund. Last week, we made a small investment in gold, via an exchange-traded fund, when gold traded below $900 per ounce. This is a dollar depreciation investment, as well. We foresee resuming our investments in other assets favored by a falling dollar, including other commodities and commercial real estate.

Our view of the world is consistent with our recent letters: The economy will recover and the banking and credit system will be repaired. But recovery has not yet begun and more pain lies ahead. More jobs will be lost. Housing prices will fall further. More mortgages will fall into default or foreclosure. More mortgage-backed securities, now held by banks, will lose value. More banking losses will be recognized. The actions by the Fed last week and the Treasury's announcement this week lessen the likely severity of these problems and shorten the duration of the pain. However, Fed Chairman Bernanke and Treasury Secretary Geithner both are quite forthright in their recognition of the likely persistence of the problems.

Investments after bear markets. It is not a novel insight to remark that this is a terrible economic recession and a wicked bear market for almost every imaginable investment asset. Our letters discuss our efforts to preserve capital in the still risky environment that lies directly ahead. It is worth raising our sights from the abyss immediately before us to consider what lies on the other side. There is good data about stock markets in the United States, Britain, Europe from the middle of the nineteenth century. Financial panics, deep recessions and grinding bear markets have been a recurring feature in these countries in the last century and a half. The history of the aftermaths of these gives reason to cheer now. The best returns for investors have come after the worst bear markets have run their course. History suggests that, from the very low valuations that prevail now for so many investments, we will enjoy an extended and very profitable investment period.

We are prepared to begin buying. We have a full roster of proposed investments and a view of what the next cycle of recovery and expansion will offer to us. This very difficult period will yield to one of significant reward for careful and patient investors.

CORE Comments

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

February 28, 2009

Financial markets reflect deep pessimism about the economy, the credit system, and investment assets. All are in poor shape now and worsening by the week.

We expect a good outcome in time, but we will keep clients' capital out of the path of this avalanche of selling. Cash and high-grade bonds are fine for now. Opportunities will be at hand when things improve. Your investment capital will also be at hand.

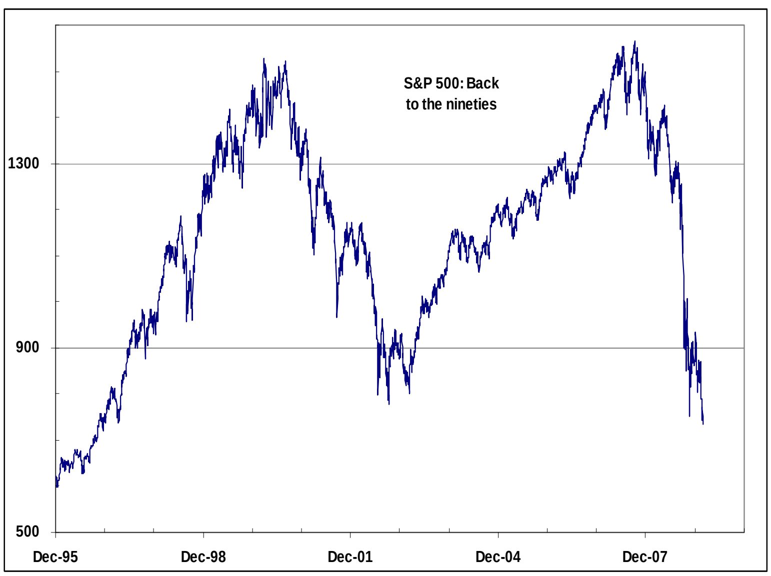
By

Jack Mayberry

Deepening Recession And Insolvent Banks

This extraordinary recession is worsening. Housing prices continue to fall; job losses rise; much of the banking system in the United States and Europe is insolvent. The optimism that prevailed in the weeks before President Obama's inauguration has been replaced by fear that the scope of the problems may overwhelm the efforts, imagination, and resources of the Federal government and the Federal Reserve. The result has been a relentless, weeks-long erosion in stocks. In recent sessions, the Dow and the S&P fell below the low levels of the 2000 to 2002 bear market, and now trade at levels last seen in 1996, as shown in the nearby chart.

As 2009 began, Core's portfolios held very small equity investments, and large cash and high-grade bond positions. We have sold more of our equity positions this year and have added to bonds. As discussed in our last letter, at this stage of the economic cycle--that of a severe and still worsening recession--it is safe to invest in high-grade bonds issued by credit-worthy companies, and in bonds of the United States and its agencies, which now include Fannie Mae and Freddie Mac. When we see real signs of economic improvement--stabilizing prices in housing, a slower rate of job losses, for example--it will be a sign that we can invest again in riskier assets, including high yield bonds and stocks.



It is unknowable when economic improvement may come--perhaps in six months, perhaps in twelve, perhaps in a longer time. We are certain that the economy will recover in time and that the banking system will become unstuck, but we do not know when these will happen. Rather than guessing, we will observe the flow of economic reports and make our investments based on reality, rather than hunches and hopes.

Solvency, Liquidity and Patience. Traders in the financial markets, the financial press, and television commentators on the scene are an impatient lot, quick to criticize the federal authorities, including the Chairman of the Federal Reserve, the former and present Treasury Secretaries, the chairs of the Congressional committees with responsibility for these matters, and the former and current Presidents. There is certainly much to criticize about policy decisions over the last decade and over the last two years. But here we are. Private investors and foreign investors, including the Sovereign Wealth

Financial markets have greeted every announcement by the Treasury with disdain and more selling. Our initial reading of last week's announcement about bank capitalization persuades us that it is comprehensive in addressing the banking and credit crisis.
Complex problems lie ahead, but the Treasury plan sets forth realistic steps to manage these matters.

Restructuring the banking system will take time. Meanwhile, the recession spirals deeper and asset prices slip further.
As this unfolds, our investment approach is straightforward: we will stick to the safest investments--cash and high-grade bonds--until we see external and real evidence that things are on the mend. Opportunities abound. We will do very well when things turn. Until things turn, we will take very little risk with your capital.

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.

Funds, have stepped aside--for good reason. The need for capital for the banking system is far greater than can be provided by the nervous private sector. The Federal Reserve and the Treasury are the only players with sufficient capital. The press and market participants are desperate for the Fed and Treasury to put things right, but too impatient to give time to see results.

It is worth considering, as one listens to the strident criticism, that some of the significant actions taken by the Fed and the Treasury have worked very well, as can now be seen. Recall the abyss into which we stared after Lehman Brothers collapsed in September. Lehman was, like most big companies, a big issuer of commercial paper for the funding of its short-term needs. Money market mutual funds were the biggest buyers of commercial paper. When Lehman failed, its commercial paper was 'impaired'--to say the least. Money funds had to write down their holdings of Lehman paper and a couple of big funds were unable to maintain the $1.00 per share net asset value of their portfolios; they 'broke the buck'. Within a few days, the commercial paper market dried up and investors began massive withdrawals from money funds. (Core joined in the exodus: we sold your holdings of Schwab's commercial paper money funds and swapped into a fund that held US treasury bills only.) The Federal Reserve, within days, guaranteed all money market fund holdings and began to buy commercial paper for the first time in its history. In short order, the commercial paper market began to function again and the stampede out of money funds ended. (We then moved back into Schwab's regular commercial paper market money funds, with their lush 1% yields.) The Fed's unprecedented and rapid action worked almost immediately and fully accomplished its purposes. Not only that, but it appears that the Fed has so far earned $1 billion on the tiny fee (about 0.01% per year) it charged money funds for its back up guarantee.

The Fed and the Treasury have solved much of the liquidity problem: The Fed has flooded the system with dollars and, through its swap lines with foreign banks, met the demand for dollars in Europe and some other countries. (Because of the interconnectedness of the world's financial systems, things have to work outside the United States, as well as here.) The liquidity crisis has subsided--at least for now--thanks to timely and creative action by the Fed and the Treasury. The problem that remains is the solvency of the banking system. It is not an exaggeration to say that much of the banking system in the United States and Europe is functionally insolvent. And further erosion of bank capital is a certainty as housing prices continue to fall and the mortgage-backed securities on the banks' books decline further.

There is no question of the commitment of the Fed and the Treasury to solve the solvency problem; my expectation is that the balance sheets of the Federal Reserve and the United States Treasury are big enough to provide the needed capital to our insolvent banks so that our credit system can revive itself and so that the we will have, in time, a functioning private banking system again. The elaboration of Treasury's plan, announced this week past, appears to address the problems comprehensively. However, even assuming the will and the resources to restore solvency to banks, the complexities are staggering. The derisive criticisms hurled at the officials considering and discussing approaches to square this fantastic circle are unseemly. But ours is a democracy. Full-throated criticism, responsible and irresponsible, is the way we stumble towards public resolution of complex problems.

Things will improve. Because we have very large holdings of cash and bonds, we will preserve your capital while things are bad and then earn very good returns when markets recover.

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

January 14, 2009

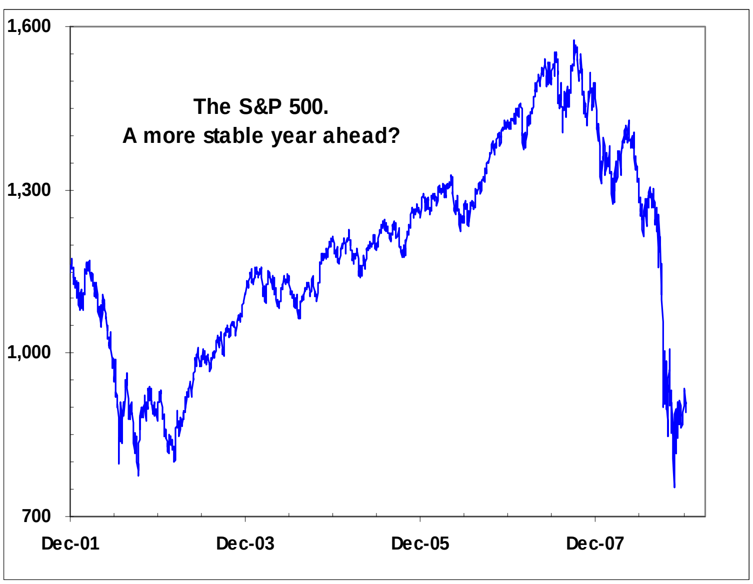
A New Administration ….
….Confronts Old Problems

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

Jack Mayberry

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 bench-mark 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.

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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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