CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

November 17, 2010

The Launch of QE2

In the first week in November came the elections and the Fed's announcement of its new round of 'quantitative easing'. The policy had been well foreshadowed in speeches by Fed members, widely anticipated in financial markets, and strongly criticized from many sides.

This letter considers aspects of the policy and offers an assessment of its effects on investment markets.

The Federal Reserve Board recently announced its plans for further monetary policy support for the economy and clarified those plans with some specificity. The Fed typically conducts its monetary policy by lowering short-term interest rates in times of economic weakness and financial system stress, and by raising short rates to dampen economic activity and/or inflationary pressures. The present risk of deflation, terribly high unemployment, and weak economic growth cry out for help from the Fed, but the option of lowering rates is not available now, the Fed having cut rates essentially to zero two years ago. Thus it employs what is referred to as 'quantitative easing', whereby it purchases assets with funds it creates. (The Fed owns the printing press that makes dollars.) At the worst of the financial crisis after the collapse of Lehman Brothers in September 2008, the Fed tripled the size of its balance sheet to about $2 trillion, by purchasing mortgage-backed and US treasury notes and bonds.

The economy faltered in the summer, in response to which the Fed announced that, as it received principal repayments for the mortgage-backed securities it holds (about $30 billion per month), it would invest the proceeds in Treasury notes and bonds, thus maintaining the level of assets on its balance sheet. In a speech in August, Ben Bernanke, the Fed Chair, reported that the Fed was actively considering new purchases of treasury debt. After the regular meeting of its Open Market Committee on November 3rd, the Fed announced the broad terms of its second round of quantitative easing, now widely referred to as QE2. It will continue the monthly treasury bond purchases of $30 billion related to the mortgage-backed securities, and will supplement that by buying about $600 billion more between now and June. Last week the New York Fed announced that the Fed will purchase $109 billion of treasuries with maturities from 5.5 years to 10 years.

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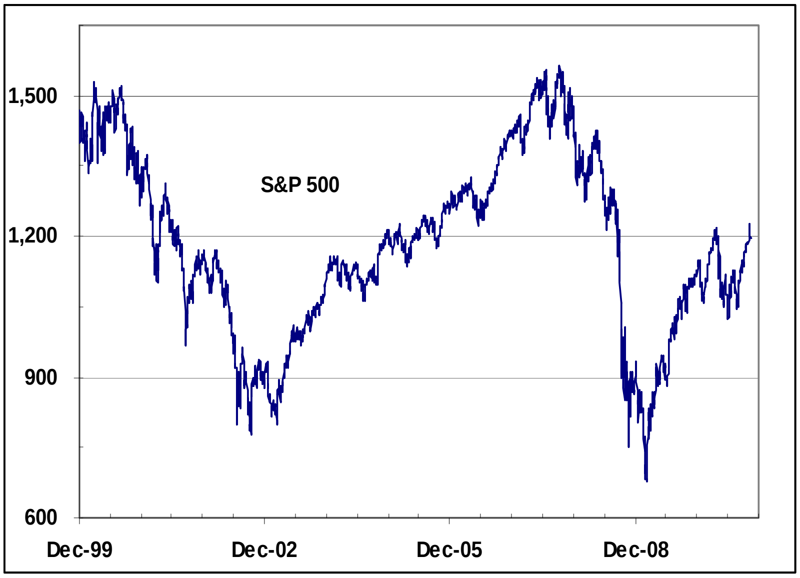
By

Jack Mayberry

It goes without saying that the Fed's actions are unprecedented, but the ideas are not new. Bernanke first put forward these ideas in a speech in November 2002, about which I wrote in *Core Comments* of January 23, 2003, a copy of which I send along with this letter. The predicament in which the Fed finds itself and the US economy is characterized by high unemployment, abnormally low levels of bank lending, inflation at about 1% and probably falling, and a political environment in which Federal and local government actions to stimulate the weak economy are largely out of the question. Although the Fed has various tools to fight deflation, as Bernanke wrote in 2002, these tools would almost certainly be more effective if co-ordinated with fiscal actions involving spending and taxation policy by the federal government. The Fed has probably determined that, in this political environment, it must fight

Bernanke's Op Ed piece may be found at http://www.washington post.com/wp-dyn/content/ article/2010/11/03/ AR2010110307372.html

deflation and the weak economy on its own. It has determined to buy a very large quantity of treasury bonds--more than will be issued over the coming months--in an effort to lower interest rates and increase asset prices. The $600 billion to be created in coming months will slosh around the globe, raising prices of many assets and, most likely, decreasing the value of the dollar against many other currencies. In an Op Ed piece in the Washington Post on November 4, Mr. Bernanke discussed his goals. A link to the article and a passage from it may be found to the left.



The Fed has two mandates: to maintain maximum employment and to foster price stability. The threat of deflation (falling prices) and the high level of unemployment demand ameliorative action. Strident criticism in the media and from many politicians complicates the Fed's work; one consequence may be that the Fed will attempt less than needed, so as to avoid arousing Congressional opposition to its independence. The ultimate success or not of these actions is unknowable now. A separate question is whether or not the Fed *should* engage in this type of monetary policy. These questions are interesting to us as citizens, but they are outside the scope of Core's work for you. Our job is to assess the likely consequences of the Fed's actions on investment assets and to make appropriate investments.

Bernanke writes: "This approach eased financial conditions in the past and, so far, looks to be effective again. Stock prices rose and long-term interest rates fell when investors began to anticipate the most recent action. Easier financial conditions will promote economic growth…. And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion."

Consistent with Mr. Bernanke's explicitly stated goals for QE2, we may expect higher prices for stocks. Indeed, many investment assets have rallied significantly since August when Bernanke and other Fed members began to discuss QE2. The dollar has fallen, not an explicitly enunciated goal, but not an unwelcome outcome. For the next six months, as this round of quantitative easing unfolds, it is reasonable to expect stocks, commodities and REITs and similar assets to rise in price. Because money flows freely round the globe, it is almost certain that a meaningful portion of the newly-created dollars will find their way into bonds and stocks of the developing economies, contributing to higher prices for these assets.

Very recent economic reports, including employment and manufacturing activity, have been better than those in the late spring and early summer. The Fed's actions may add a bit of oomph to all this, but consumer spending remains very poor, suggesting that the forces of deleveraging--less spending and more saving by wary consumers--are still strong. These will necessarily restrain the economy. The Fed has a tough fight before it.

After increasing our equity and commodity investments in September, we recently made some further changes. We sold our very long-term treasury bond positions and made an investment in an exchange-traded fund holding treasury bonds with maturities of 7 to 10 years. These are within of the range the Fed's QE2 purchases. We sold about half our very successful gold investment and bought silver with the proceeds. Gold has attracted buying as the anti-paper currency investment. We expect gold and silver both to rise further in price. There are fears that deficit spending and quantitative easing will lead to hyper-inflation. To our thinking, this is bunk, but we recognize the demand for precious metals, well-founded or not. In the last week, many assets that had risen steadily since late August have begun to trade down. We may use some of our cash reserves for new investments in weeks ahead.

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

October 9, 2010

A Review of Investments

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

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

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

By

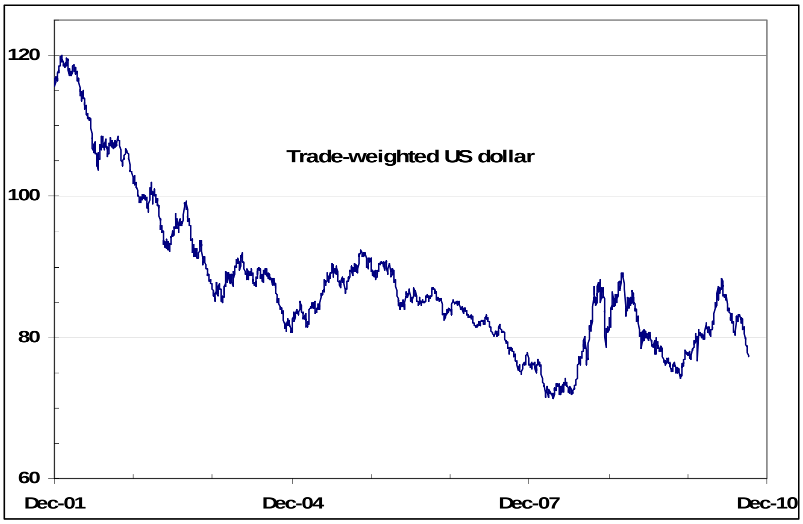
Jack Mayberry

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

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

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

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



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

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

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

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

A Further Note on the Mutual Fund Settlements

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

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

September 7, 2010

Bonds and Stocks in a Weak Job Market

Yields on long-term treasury bonds have fallen like a stone since late April, when economic recovery began to falter. Since then, economic reports have been bad and getting worse, especially the employment reports. Because of political opposition to further spending by the government to stimulate the economy, it has fallen to the Fed to use its tools. It is almost a certainty that short-term rates will remain low for a very long time, and the Fed has begun again to buy long-term treasury bonds.

Whether the Fed's actions will stimulate the economy may be doubted. What seems clear is that high-grade, long-term bonds--especially treasuries--will be very strong in price. Their yields are likely to fall to still lower levels. Core will buy more treasury bonds.

By

Jack Mayberry

I write after the first three days of September. Stocks bolted from the September 1 starting gate like Secretariat at Belmont. The economic reports of the last few days have not reminded anyone of famous race horses, but they have been better than feared. So, is all right with the world? Not quite.

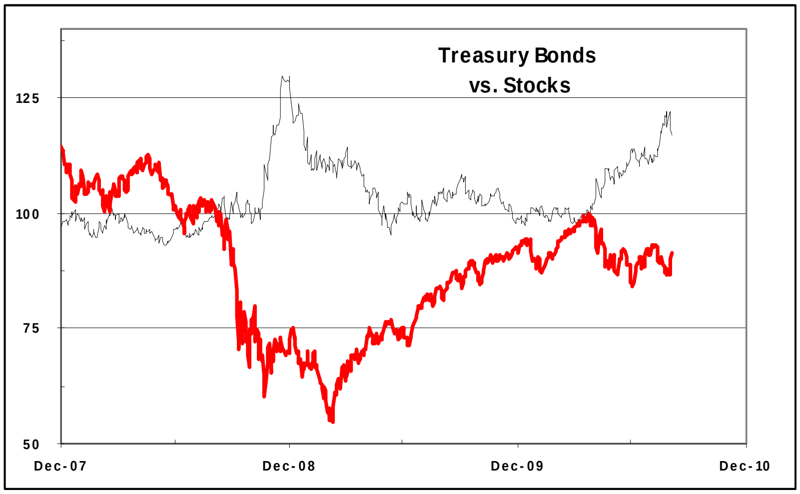
"Green shoots", presaging economic recovery, began to appear in the spring of 2009 and the stock market began its recovery from the tremendous declines into March 2009. The stock market climbed robustly until April of this year, and, for much of that time, the economic reports were consistent with a vigorous recovery. No longer. As discussed in recent letters, the stock market has fallen sharply and economic reports have revealed an ever-slower economy. The worst aspect of this has been the very poor growth in new jobs. The temporary hiring for the census provided some big headline numbers for a couple of months, but it is quite clear now that few of these temporary workers have found jobs in the private sector. On Friday was the employment report for August; it was not as awful as expected, but the growth in private sector jobs was only about 60,000, a rate far, far lower than needed to make a dent in the 8 million job losses in the recession. At present, there is little prospect for robust hiring in coming months.

The growing awareness that economic recovery is halting and sluggish and that political opposition to another dose of economic stimulus is quite powerful leads to the conclusion that the Federal Reserve will maintain its very easy monetary conditions far into the future. The Fed has affirmed this and has begun to buy long-term government bonds again in an effort to keep rates low and to stimulate economic activity. All this has caused interest rates to decline very sharply since the spring and for bond prices to rally very vigorously. (The chart on the next page illustrates this.) Our very large bond positions and quite small equity positions have served us well during this period. In August, for example, when the US stock market fell by more than 4%, Core's accounts overall rose in value by more than 1%.

Assume that the US economy will remain rather weak, or even contract in this and future quarters. Assume further that job growth will be very poor and that the unemployment rate, most recently measured at 9.6%, remains high. Does this mean that the stock market will be weak? I do not believe so. Monetary policy, especially the very low interest rates and the near certainty that rates will remain very low for a long time, is very favorable for stocks. Corporations have strengthened their balance sheets enormously since the 2008 financial crisis, partly out of fear that another disruption in the credit markets would close the usual markets through which companies meet their

The chart below shows the total return of the S&P 500 and of long-term US treasury bonds, 'rebased' to show each with a value of 100 on April 23, 2010, the top of the stock market's recovery and the beginning of the realization that 'green shoots' were turning brown.

short-term funding needs. Companies have lowered costs--in part by cutting staff--and raised profits. These forces are a restraint on job growth, but it is clear from the historical data that periods of high unemployment produced far better returns than did periods of low rates of unemployment. (Stocks fall as recessions unfold and generally begin to recover before the recession ends. Those recoveries--like the one from March '09 to April '10--are generally very powerful. In the later stages of the economic cycle, when jobs are abundant and unemployment low, stock market gains have typically been mediocre.) The human cost of high unemployment is awful; for better or for worse, the stock market looks to the improving corporate profits during those periods and tends to perform well.



Core foresees an environment in the coming year in which US economy is weak, unemployment remains high, monetary conditions are very favorable, and the political stalemate in Washington paralyzes new policy initiatives. We foresee a very strong bond market and expect that our fixed-income investments will continue to thrive. We intend to use periods of weakness in the stock market to make investments in the portions of the equity markets that have the best prospects. Among other things, we will build on our existing investments in stocks and bonds in developing countries.

The heavy line is the S&P. As it collapsed in the financial crisis in 2008, treasury bonds soared in price, as a safe haven investment. As the markets and economy recovered, stocks rose and bonds fell. In April of this year, the course reversed: Treasury bonds are gaining in price, against the risk of deflation, and stocks have fallen. Bonds will go still higher in price, but stocks should gain again, as well.

A Mutual Fund Settlement

We receive the occasional notices of mutual fund litigation and announcements of settlements of class actions against funds. Often the settlements are tiny (and appear to benefit only the lawyers bringing the litigation). However, we and many of you have recently received notice of a settlement involving a mutual fund family, in one of whose bond funds Core's clients had an investment in the early years of this decade. The fund is the Strong Government Securities fund. In this case the settlement is meaningful. We have looked through our records of investment in this fund and can see that the settlement will pay hundreds of dollars to a number of Core clients who held the fund. In speaking to the organization handling the settlement payments, we have learned that we can act on behalf of our clients to prepare the necessary paper work. We will send to clients who had investment in the fund a letter for your signature, which will authorize Core to act for you in submitting the information relating to the claim.

The claim in this action against the Strong mutual fund group related to the rather egregious mutual fund scandals that were uncovered several years ago, involving so-called "late trading" and "market timing". I wrote about this in *Core Comments* in late 2003; I include a copy of that letter with this one. The Strong group does appear to have been one of the 'bad apples'. Without having studied this closely, I very much doubt that the government bond fund in which Core made investments for you was a participant in the shenanigans. It was stock funds in which the bad actors went to work. We are looking into a similar class action claim against another group, Invesco, in whose funds Core had investments for clients. We will report on that if there is any recovery available to Core's clients. Please contact us, if you have any questions.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

August 15, 2010

Roth Conversion

Converting a traditional IRA to a Roth IRA will trigger possibly substantial tax payments in 2011 and 2012. Although it rarely makes sense to accelerate a tax liability, this may be an exception.

It probably will be a benefit to most people who do not expect to draw from their IRAs for a decade, and for those who expect to leave some portion of their IRAs to heirs.

Core has prepared the tools to analyze whether converting one's IRA (or other qualified plan) to a Roth makes sense for a given individuals and we are ready to help any clients who wish to consider how this may apply to them personally.

By

Jack Mayberry

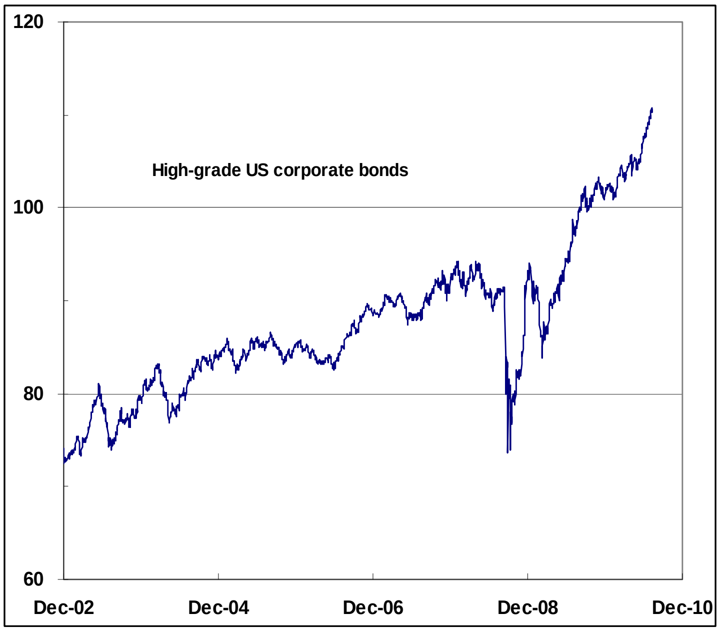
In our *Core Comments* from last October, we wrote about the tax law changes that permit anyone, regardless of income, to convert a traditional IRA (or other qualified plan) to a Roth IRA in 2010. We have studied this matter further and we are prepared to help individual clients analyze whether conversion to a Roth makes sense. We include with this letter ours from last October, which gave a summary description of some aspects of this matter.

Without attempting to describe Roth conversions fully in this letter, I would make two points: First, if one converts a traditional IRA to a Roth this year, one incurs an obligation to pay ordinary income tax on the value of the Roth, less any non-taxable contributions made. The tax is payable, at 2010 rates, in two equal installments in 2011 and 2012. This can be a significant tax liability. Second, the benefit of Roth IRAs and the potential benefit from conversion to a Roth is that all distributions from the Roth in the future, including all investment income earned after the conversion date, are not subject to tax. This feature is what may make a conversion advantageous, despite the obligation to pay a big tax bill presently. This is likely to be especially advantageous to those who expect to be able to pass on to heirs some or all of the value of the Roth upon death.

The trade off in this has to do with the obligation to pay taxes in the next two years that otherwise might not be payable for years to come, against the opportunity to earn investment income on a Roth that will never be taxed. Even assuming that one earns a low investment return in coming years in one's Roth, as time passes, the compounding effect of the never-to-be taxed investment income may well be far greater than the present tax liability. For this reason, a Roth conversion now makes sense if one expects not to draw much from one's IRA for a number of years. It can be an especially attractive estate-planning scheme, if one can expect pass on to heirs the value of a Roth at one's death.

The analysis of all this is full of variables and can be rather complex. Given the variables, given the uncertainties about the assumptions one must necessarily make, there can be no assurance that a conversion makes sense, even if the analysis suggests a good outcome. However, we can perform an analysis and show you what are the variables and what are expected results, so that you can make an informed decision. The opportunity to convert exists in this calendar year. If you would like to have us help you make a decision about its applicability for you, kindly let us know and we will get to work. Call at 415 332 2000, or email me at JNMayberry@coreasset.com to discuss this.

The chart below shows the total return (interest payments included) for an ETF we use for US corporate bonds. After recovering from the panic selling in 2008 at the worst of the crisis, these bonds have continued to move slowly higher in price and to pay the healthy 5% dividend. We expect this to continue.



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The Economy and the Markets

The flow of economic news in the United States has generally been quite poor since April. The 'green shoots' of the early and middle parts of 2009 sprouted and flowered for a time. Sadly, the crop seems to have gotten scorched by a debt-deleveraging sun before seeds for future harvests could germinate. Stocks fell fairly sharply from April to now, with a four-week respite and a decent rally in July. In itself, the selling in equities in recent months has not been too remarkable; it may turn out to be little more than a 'pause' in the second year of a cyclical bull market.

The contrast with the bond market is striking: as the S&P has fallen by about 11% since the high in April, high-grade US corporate bonds have earned have earned about 3%, including interest. The story the bond market seems to be telling us is an ominous one: the economy is weakening and the risk of deflation lingers. Equally worrisome for those who would like to see the economy recover and for more people to find good jobs--probably everybody--is the response by the Federal Reserve. It chairman Ben Bernanke gave rather gloomy testimony to Congress a couple of weeks ago, but, in the Fed statement released on Tuesday after its regular meeting of the Fed Open Market Committee, the Fed was gloomier still. Bernanke and the Fed's official statements are worded very carefully, so we can probably be sure that the gloomy and gloomier reports were intended and meaningful.

As discussed in our letter several weeks ago, we began to reduce stock and commodity investments in May and we have continued the process. We have invested the cash proceeds of our sales in US and foreign bonds. The prices of bonds have been rising over these recent months, in response to growing fears of renewed economic weakness, the possibility of deflation, and the remarkable strengthening of the balance sheets of corporations. It is widely known that, despite the terrible employment environment and generally weak growth, corporate earnings have been remarkably high. As companies have earned growing profits, a large portion of the earnings has stayed in corporate coffers, improving the financial strength of companies. Returns on bonds held in Core's clients' accounts have been favorable so far this year, up about 7% for our US bonds and by more than 11% for foreign bonds. Returns may improve in a weak economic environment teetering on the brink of deflation.

We have by no means given up on equities; we still hold some and we have plans to buy more. However, in the economic environment that obtains now, the risk to stocks is high. If economies worsen, as now seems likely, and if another wave of market panic strikes, stock prices could tumble. If things unfold this way, including with lower equity prices, stocks will become very attractive once again. We anticipate being active then as buyers of stocks; a slow-growth environment, with very favorable monetary conditions and cheap stock prices is a propitious time to buy stocks. In essence, the environment of recent decades, characterized by fairly consistent growth in the stock market and expansion of credit, is over. Now the private sector--and soon the public sector--is reducing debt. In this period, there will be plenty of very good investment opportunities, but they are likely to be of somewhat shorter duration, and to require us as investors to be more selective, more patient and more opportunistic.

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

July 6, 2010

The Evidence Tips toward the Bears

Will this be seen as a 'soft patch' in economic recovery, or the beginning stages of more serious economic weakness? Recent economic reports bode ill, at least for the coming months.

We have shifted portfolios toward safe bond investments.

The growing clamor in developed countries around the world to withdraw government support for recovering economies, arising from fears about big government deficits, puts the economic recovery at risk.

Private sector economic activity may not be strong enough now to sustain economic growth if government support comes to an end. Fear of sliding back into recession is one that has afflicted the markets in recent weeks.

By

Jack Mayberry

In early June we wrote suggesting that, while it was a close call, the evidence offered by economic reports and the market's action supported bullish views, namely that the economy would continue its expansion and that selling in stock markets since late April would give way to a resumption of the cyclical bull market that began in March 2009. Since then, however, the flow of economic reports, the global political climate, and continued selling in stocks have strengthened the bearish arguments.

As you will have seen from the trade confirmations for your accounts that Core manages, we have steadily been selling the 'risk' assets in your portfolios and increasing your investments in safe bonds. In a series of sales beginning on June 8, we reduced equity and commodity investments from about 45% of total portfolios to about 30% as of the end of last week, and increased the safe assets (bonds, gold, and money funds) to about 70% from around 55%. (These figures are for the aggregate of all of Core's accounts; proportions in individual accounts vary according to individual considerations of investment goals and risk tolerance.)

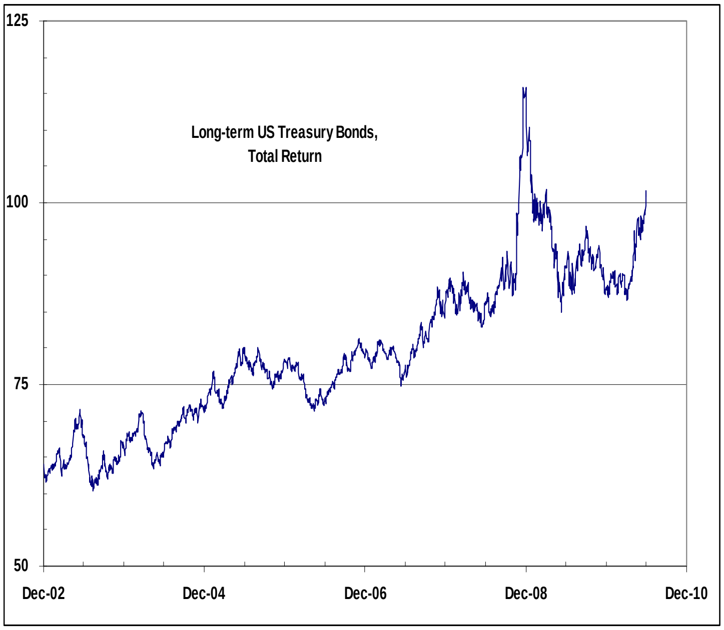
Economic problems… Job creation has been weakening in the recent two months and new claims for unemployment insurance remain stubbornly high, at levels consistent with recession. This translates, unsurprisingly, into weak retail sales, especially because individuals are continuing to save more of their income than in the free-spending period a few years ago. Manufacturing and export activity in the United States have been strong, but the developments in Europe do not bode well for their continuing strength. Europe presents two problems: first, the very weak euro makes competition with German exporters much tougher; second, the extremely poor economies in the euro-zone are unlikely to be big buyers of US exports.

...unsupportive fiscal policies… The politically potent cries in Europe and the United States to attack fiscal deficits now pose very serious risk to global economic recovery. When economies collapsed in 2008 and the banking system failed, businesses and individuals rapidly cut debts and reduced spending. It was only national governments with the will and the wealth to take up the slack, to expand spending, and to try to keep the wheels from falling off. At the worst of the crisis, there was a strong consensus to favor public support for faltering economies. There was apparent recognition that, if governments stood aside, depression and deflation might follow, as occurred when President Hoover tried to balance the budget in the early 'thirties. But now, Britain's new government has introduced a budget that will cut spending significantly. Greece and the other weak Mediterranean countries are being

The chart below shows the total return (including interest payments) of long-term US Treasuries. The spike upwards at the end of 2008 marks the rush to invest in these during the most acute phase of the crisis, when every investment except US and Japanese government bonds plummeted in value.

forced into more Draconian spending cuts and the European Central Bank has begun the process of removing its support from the European banking sector in the face of mounting losses from the sovereign debt of these countries. At the recent meetings of the G20 countries, it appeared that the United States stood somewhat alone in advocating continued government support to stimulate economic recovery; most others argued that the time for fiscal restraint had come.

The stridency of the Tea Party movement here forces Republicans to withhold support even from the extension of unemployment benefits. There is an ever-growing likelihood that public support for the still-weak economies will be withdrawn before private economic activity is strong enough to sustain economic growth. There is growing risk that economic activity in the second half of 2010 will falter and that the reasonably robust growth of the last nine months will come to an end.



… and poor stock market action. We have moved to larger investments in high quality bonds to guard portfolios against these risks. By our analysis, there is a greater risk now than since early 2009 of another large decline in stocks. Because governments and central banks used so much of their wealth and resources at the worst of the 2007 - 2009 crisis, there is less ammunition in reserve and less political will to fight a renewed crisis in economies, financial markets and the banking system. We cannot ignore the possibility of another 'riot' in stock markets.

Attractive bond investments. One of the very healthy results of the crisis is the strengthening of corporate balance sheets. As noted above and in earlier letters, the crisis induced individuals and business to stop spending, pay down debt, and restore financial strength. As a result, bonds of American companies have been superb investments and, with improving balance sheets, ever safer ones. We have had large and very productive investments in US corporate bonds since the depths of the crisis; we anticipate continued favorable returns from these. We have been increasing our investments in bonds of developing countries in recent months. Unlike the developed countries, some of which are insolvent, many developing countries have strongly growing economies, low taxes, few unfunded liabilities (e.g., Social Security and Medicare), and large trade surpluses. Things have turned somewhat upside down over the last decade and developing countries now offer safer bond investments than many developed industrial economies. Most recently, we made a small investment in long-term US treasury bonds, for two reasons: first, in a crisis, capital flocks to Treasuries as a safe haven. Second, if the economy does slide back into recession and if deflationary pressures continue, these bonds will increase in price and their yields will fall further. The yield on the ten-year Treasury, for example, touched 4% in early April, before the recent signs of economic weakness showed themselves and before the Greek-debt crisis reached the boil. Since then the yield has fallen to just below 3%. At the most acute phase of the financial crisis in December 2008, the yield was 2.1%. To gauge what may happen if economies weaken further, consider that Japanese ten-year government bonds, during the seemingly endless years of deflation and recession in Japan, have yielded around 1%.

We cannot be pleased with apparently worsening conditions, but we invest for what is, not for what we hope.

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

June 4, 2010

A Uncertain Juncture

Do the recent weeks of selling and increased volatility mark the beginning of a renewed bear market? Or is this a normal correction in a cyclical bull market? In our view, this is a modest interruption in an ongoing bull market.

Economic growth is robust in much of the world. Monetary and fiscal policies remain very supportive of economic growth and investment assets.

Risk remains high. Public sector debt in Europe, Japan and America is at unprecedented--and unsustainable--levels. Policy makers must balance political pressure to reduce deficits against the need to keep stimulating a still-fragile economy.

By

Jack Mayberry

The recent tumultuous action in financial markets poses a simple question, so far unanswered: Are we pausing in a 'normal' cyclical bull market that will probably continue for another two years or more, or are we now at the second precipice of the huge credit deflation disaster that began with the 2008 collapses of Bear Stearns, Fannie Mae, Freddie Mac, AIG, and Lehman?

In our view, it is the former. We are in the midst, we think, of a modest stock market decline in the context of a cyclical bull market and a global economic recovery. But this is a close call and our confidence in this judgment is not terribly high. We have a fully articulated plan to sell investments that are at risk if the evidence tells us that our judgment is wrong. There are two sides to the argument. Our bullish view first:

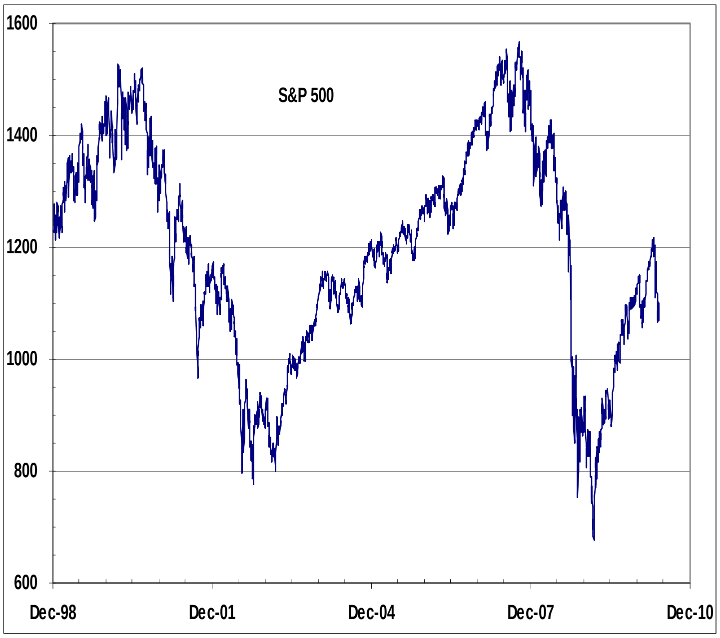
A pause . . . After the financial calamity of 2008 that projected its havoc into the early months of 2009, the exceptional actions of the central banks and the treasuries of the major countries restored a modicum of confidence. The abyss lay before us in March 2009; we pulled back from it. The unprecedented acts by the Fed and the Treasury--including recapitalizing the big banks, insuring all deposits in money market funds, buying commercial paper, taking onto the Fed's balance sheet dodgy mortgaged-backed securities, and more--halted the collapse of the world's economy and its financial markets. The low point--a very low point indeed, 58% below the S&P's high in October 2007--came in early March of last year, from whence began the rally.

The stock market rally began before the economy began to recover, as always happens, but in time manufacturing, consumer spending and employment began to grow. Unsurprisingly, rates of economic recovery differ in various parts of the world. China's recovery was early and very strong, so much so that Chinese authorities have taken actions for months to cool its economy. Economic recovery in the United States began in the third quarter last year; it has been broadening and deepening. Economic activity in Europe, the UK, and Japan has been far weaker than in China or the United States, but, taken as a whole, the world's economy is growing again. The enormous stimulus provided by the federal government and the Federal Reserve continues. Given this environment, the likelihood of another phase of economic contraction--the feared 'double-dip' recession--is low. It is likely that the last six weeks of selling in stock markets is a temporary pause in a bull market that should last for more than another year and take prices higher.

. . . or at the precipice? The 2008 crisis caused individuals and private companies to reduce their levels of indebtedness quickly and deeply. This caused

The selling since late April is like that in early 2004, a year into the cyclical bull market that began in 2003 and ended in late 2007.

a rapid, sharp and deep recession. Only the central banks and governments could take on more debt. And did they ever: According to David Rosenberg of Gluskin Sheff, a highly regarded analyst, $200 trillion of global debt was transferred from private hands to 'taxpayer-supported public sector balance sheets' since the crisis began in 2008. Government deficits and central bank balance sheets exploded to levels never seen before. In recent months, it has become painfully clear that debt levels in some countries--Greece is just one example--cannot be sustained. The solvency of major countries is in doubt. The fear is that, as governments are forced to reduce deficits by cutting spending, economic recovery will falter and recession will resume. Should this happen, central banks and governments will not have resources to stimulate demand. A downward spiral in financial markets will commence.



The market's action in the two weeks after the May 9th announcement of 750 billion Euro package to deal with the sovereign debt problems illustrates the problem. It was clear that the size of the promised package would be sufficient to deal with *liquidity* needs of Greece and the other southern European countries. But, after an initial rally in global stock markets, selling resumed on the realization that the rescue package did not remedy *solvency* issues. Although the 750 billion Euros will enable the southern European countries to borrow new funds without resort to inhospitable public markets in the next two years, the longer-term ability of the Greek government to generate sufficient revenue to make timely interest and principal repayments is highly doubtful. The markets take the view that the Greek government is fundamentally insolvent and that its existing debt will most likely be restructured. In a default or debt restructuring, the holders of Greek debt will be forced to accept partial repayment.

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Apart from the solvency problems is the realization that public policy makers--central bankers, governments, treasury departments--are making the key decisions that affect financial markets in this very complex new world. There is real fear that mistaken judgments by any of a very large number of policy makers can cause serious problems with adverse global consequences. The scope of the debt problem and the complexities in dealing with it are enormous. All levels of US governments--federal, state, and local--have too much debt and too little tax revenue to support their obligations. Losses at Fannie Mae and Freddie Mac--now wards of the state--are enormous. Unfunded liabilities for future entitlement payments for public sector workers, for heath care payments, and for Social Security are daunting. One of the many risks in all of this is that the political pressure to reduce public spending and to begin deficit reduction may remove the government's economic stimulus before the economic recovery can be sustained by the private sector. Turning off the spigot of public-sector economic support too early may return us to recession.

Conclusion. The bearish case is a grim one, indeed. We think the better argument is the bullish one and we expect higher prices for risk assets and higher values in Core's clients' portfolios in the next twelve and twenty-four months. Having said that, we have fresh memories that things can go badly quite suddenly and quite swiftly. The portfolios we supervise have large holdings of very safe bond investments and gold, positions that will protect us if things go badly. Please do not hesitate to contact us, if you wish to discuss our investments for you.

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

May 9, 2010

Tumult Again….
… but with the Wind at our Backs

As the Greek debt crisis worsened and European leaders dithered, waves of selling swept across global markets, interrupting the strong recovery in stock markets.

In the midst of another bout of fear and indiscriminate selling in global markets, it seems the occasion to write again. After some dalliance with Goldman's misdeeds in arcane securities (which may well affect the future schemes of regulation of bankers and traders and markets), the sovereign debt problems with Greece and the slow unwinding of the Euro took command of investors' attention. On Thursday, we were treated to the inept performance of Jean-Claude Trichet, the head of the European Central Bank, as he carefully explained that the ECB would not take extraordinary action to counter the deflationary aspects of the crisis. Afterwards, our attention was directed to the ongoing demonstrations, strikes and riots in Athens, while its Parliament reluctantly debated the choices on offer: disaster or catastrophe.

As we watched some live TV from Athens, showing a line of calm, heavily armored police facing a line of young, unarmed protestors, the US stock market was absorbing a third day of selling, down about 300 Dow points. In a weird kind of simultaneity, the Dow began to drop precipitously and the baton-swinging police moved forward. An unfortunate lad stepped into the line of police and received a painful whacking. At the same time, the machinery of the US stock market went haywire. Stock in Procter & Gamble, the unassailably strong consumer products company, which had been trading at 62 at 2:40, was suddenly shown to have changed hands at 46. The Dow, in which P&G is a big component, suddenly began a spiral down. Within minutes, it had fallen by more than 950 points. Other important stocks also fell by 30% or more (Accenture fell by more than 95%). But then, within a few minutes, the weird declines were reversing, and within a half hour, the market was back to its level of an hour before. The system had failed, in ways not yet known as we write on Sunday.

Things are a mess, it appears.

By

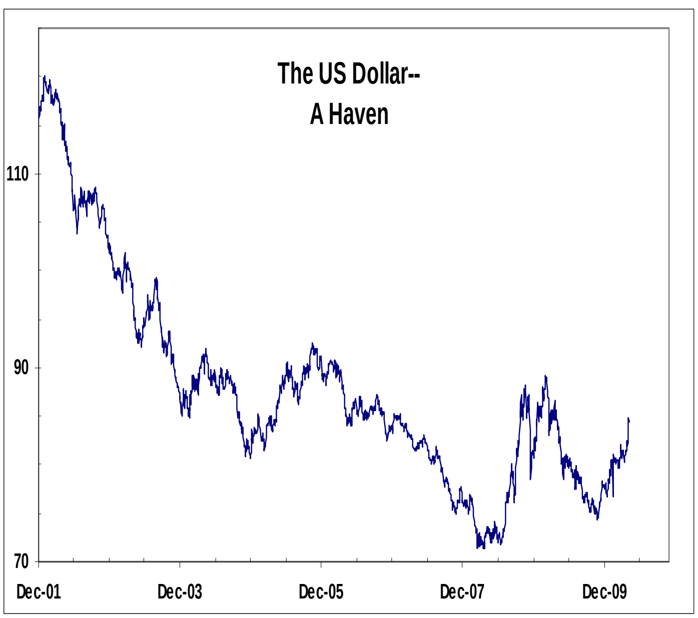
Jack Mayberry

Investment prospects now. Before discussing aspects of the disorderly markets and the problems in Europe, a word on investment prospects. From the summer of 2008, as Fannie Mae and Freddie Mac were at the point of failure, through the collapse of Lehman in September, and until March 2009, *The crisis in Europe has weakened the Euro and put into question its long-term survival. The US dollar is seen once again as a haven during crisis, as it was during the acute phase from the summer of 2008 until the spring of 2009. It has been rising this year.*

As discussed in previous letters, some minor currencies (e.g., the Canadian and Australian dollars) and a number of currencies of the developing Asian and Latin American economies have been stronger even than the dollar. We expect those currencies to remain strong.

the growing catastrophe in the financial world made the collapse of the banking system and the investment markets seem a distinct possibility. The Federal Reserve Board, the US Treasury and Congress undertook a series of policy actions entirely without precedent. In time, it became clear that the extraordinary set of actions was sufficient to stabilize the banking system and the financial markets. Slowly banking began to return to more normal functioning and markets began to recover from the lows of March 2009. Because all investment assets--with the exception of the US dollar, the Japanese yen, and US and Japanese government bonds--fell very sharply in the nine months until March 2009, the subsequent rally was very widespread and it was very powerful.

The severe recession in the United States continued after markets began their recovery, but the economy resumed growth in the second half of 2009; growth has continued this year. Indeed, after the terrible loss of jobs--more than eight million in the United States--jobs are now being created again at a reasonably robust pace. The recovery owes a great deal to the largesse of the federal government, just as the healing of the banking sector is unfolding because of exceptional policy actions of the Fed and Treasury. It is not at all certain that growth is self-sustaining yet; that is, one cannot be sure that growth would continue without government support. It would be a risky and unwise experiment to withdraw that support too early. The Fed and the Obama administration have no wish for the federal government to stand aside now, but there is an ever-louder chorus of protest against the deficit spending. It is apparent that the Republican party will contest the November elections by campaigning against the emergency policies and spending.



In our view, the bull market that began in March 2009 will continue at least for the rest of this year, and probably for longer. We have had brief bouts of selling since last March--in June and July and in October last year, in January this year, and now again. We expect this present round of selling to come to an end and for the stock market to continue its advance. Other bouts of selling will emerge in the course of this cyclical bull market, but the favorable conditions that now exist will continue to support the stock market. These favorable conditions include the Fed's very accommodative monetary policy, the improving economy, growing corporate profits, and the continuing economic stimulation by the federal government. As discussed below, probable future actions by the ECB may enhance all of this.

Greece and Europe; Democracy and Inaction. The sovereign debt problem facing Greece has been quite apparent for some time. The risks of inaction--namely that the crisis would spread beyond Greece to Portugal and Spain and would become much less amenable to resolution--have likewise been apparent. The solutions, too, have been fairly obvious. Because the world has so recently suffered through a banking crisis, the playbook for handling this is well known and at hand. I wrote about this in a letter in March and there is little new to say, except about the long delays in putting a plan in place and a discussion of possible outcomes. (The March letter may be found on Core's website at http://www.coreasset.com/publications/archive/mar2010corecomments march112010.pdf.)

The plan on the table and being enacted in various European capitals involves

A political consensus on how to handle the sovereign debt of the southern European countries has been impossible to achieve. While the debate has gone on, market forces have shown the conditions to be unsustainable.

Something must give.

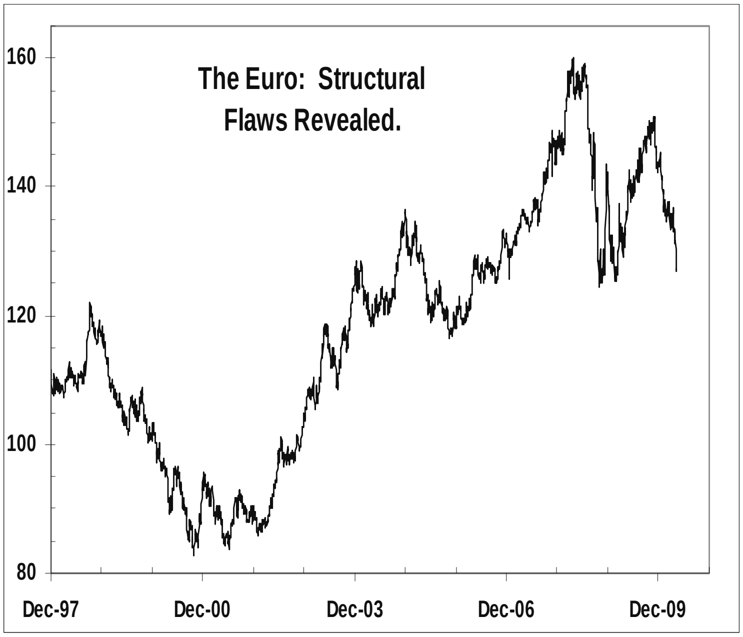
funds from the Euro-zone countries and from the International Monetary Fund (the "IMF"). The deal will put Greece in a terrible fiscal straitjacket, involving much higher taxes and much lower spending by the Greek government. Because the rolls of public employees in Greece are so large, the cut in spending translates into far lower pay for Greek workers. In return, the government of Greece will not have to borrow money on public markets for about three years and, for now, at least, there will be no default and re-structuring of existing Greek sovereign debt, mostly held by European banks. If this all comes about, then the Greek economy will suffer an enormous deflationary shock and a terrible recession. Economic output and income will fall sharply.

Because of fierce political opposition in Germany to the 'bail out' of the Greeks, the plan has existed solely in the realm of imagination for the last couple of months, during which time the financial markets have measured the likelihood of default on existing debt and the improbability of this working. The result is much higher borrowing costs for Greek, Portuguese and Spanish debt. A former French finance minister, Alain Madelin, summed up the situation succinctly: "Politicians are saying that markets are acting irresponsibly, but instead what is really happening is that markets are starting to ensure that politicians act responsibly."

With the entry of the Greece and others into the Euro zone some years ago, the borrowing costs for the governments of Greece and Portugal became essentially as low as for Germany. This caused a large-scale misallocation of capital. Greece and Portugal were nowhere close to being as credit-worthy as Germany, but they could borrow as if they were. Capital flowed to Greece, Spain and Portugal at very low cost and in high volumes. This resulted in high wages for Greek public workers and way too many new houses in Spain. It was a poor use of capital and it seems quite likely that a good deal of it will not be recovered.

The outcome for the Euro is very uncertain; some 'peripheral' countries may leave the Euro. The entire single currency experiment may end. The inherent structural flaws with the Euro, about which I wrote in March, are now in plain view, and the Euro's status as a reserve currency is in serious doubt. (Central banks are estimated to have lost $300 billion in the value of their Euro holdings so far this year.) Over the next several months, the European Central Bank will likely be forced to adopt the kind of quantitative easing undertaken by the Fed beginning in the latter part of 2008, in order to offset the deflationary shock in Europe. This will probably stimulate economic activity, at least in the 'core' northern European countries like Germany and the Netherlands, and it may well bring about a sharp rally in European assets.

More Chaos in Financial Markets. After months of calm and rising prices, volatility and selling came back to the markets in the last two weeks. The deterioration of conditions in southern Europe was the prime cause, and it seems quite likely that the Greek problem will continue to unsettle the markets in the weeks and months ahead. Could turmoil in southern Europe evolve into a global financial crisis, akin the one that unfolded after the collapse of Lehman? I very much doubt this. When Lehman collapsed, the economy was already in recession and monetary conditions were far less accommodative than now. The backdrop to the Lehman collapse was the bursting of the US housing market bubble and the credit bubble. The southern European problems are of a far, far smaller scale. The global economy is now expanding robustly and the policy tools to handle the crisis are tested, understood, and ready to be deployed. The European Central Bank has been slow to act, but it seems probable to me that the crisis will force action. The monetary actions needed to offset the deflationary aspects of the Greek 'rescue plan' will be very stimulative to the European economy and to financial markets. Add to this the likelihood of a still weaker Euro and it is not hard to imagine an export-led boom for France, Germany, and the Netherlands.



Market dislocations. The stock market action on Thursday afternoon was quite disturbing. The US stock market broke down in what seems to have been a failure of systems, most likely related to so-called 'high frequency trading', in which computer-generated algorithms trade on the slightest movements and for the shortest duration. In a few minutes, the Dow fell by 700 points, then regained 600 of those points shortly thereafter. Many individual stocks and funds experienced inexplicable and extreme losses.

We took advantage of this chaos, by buying more of the emerging market bond fund we hold in most client accounts. For the last several months, this fund has traded quietly between 12.60 and 13. On Thursday it began to fall from 12.60, and traded below 11.40 during the mid-afternoon tumult. This is for a fund that pays a dividend of $1 per year as it collects interest from its bonds. On Friday, we increased our investment from about 3% to 6% at an average price of about 12 even. We have been hoping that we could buy this fund at a lower price, and this week we took advantage of the temporarily low prices. We will be happy if we can make other attractive investments in coming weeks; we have our eyes on a German stock fund, which has fallen by about 20% in the last few weeks. As discussed above, we think the southern Europe problems will have a good result for many German companies.

Notwithstanding opportunities that market dislocations create, Thursday's trading problems leave a very sour taste, particularly coming so close to the unsavory news about Goldman. If these events do not make a compelling case for restructuring and regulating the banking and trading systems, I cannot imagine what can. However, the sheer complexity and the opacity of existing systems make it quite hard to know what structure and what regulations will work. Then, assuming that we articulate an effective and intelligent set of reforms, politics comes into play. The banking industry lobbyists are tenacious; they command the attention of many legislators of both parties. In addition, the avowed interest of Republicans to thwart any and all legislative initiatives of the administration make the enactment of good financial reform quite tricky, to say the very least.

This story will continue.

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CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

April 19, 2010

Goldman Sachs and Banking Reform

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The egregious aspect of Goldman's actions, as alleged in the complaint by the SEC, is its deliberate actions to mislead one set of its clients (the buyers of its ABACUS synthetic collateralized debt obligation (the "CDO")) so as to serve the interests of another client (the Paulson hedge fund). The complaint lays out the process in clear detail: at certain stages in the creation and marketing of the CDO, third parties raised questions about Paulson's role. According to the complaint, Goldman let it be understood that Paulson was investing in the mortgage-backed securities associated with the CDO. In fact, however, Paulson was choosing the particular securities to be included in the CDO, so as to be able to 'short' the CDO, that is, to take investment positions that would benefit it if and when the securities fell in price. If the allegations of the complaint are true--and they probably are well-supported by evidence Goldman and others have turned over to the SEC--the CDO could not have been successfully sold to investors (who ultimately lost about $1 billion invested in the CDO) unless Goldman had misled those involved with the fund about Paulson's role. For its part, Paulson fund paid Goldman $15 million and was paid about $1 billion for its short position against the CDO. The complaint, not terribly long, may be found at http://www.sec.gov/litigation/complaints/2010/comp21489.pdf. Goldman denies the allegations.

The principal of the Paulson hedge fund indentified in the SEC complaint is John Paulson (no relation to the former Treasury Secretary), who correctly analyzed the weakness in subprime mortgage market. He approached Goldman about creating a CDO associated with securities he deemed to be more highly rated than warranted. Paulson's fund was one of the biggest winners 2008 as the mortgage market collapsed.

Conflicts of interest necessarily arise in financial institutions of Goldman's size, which represent a very diverse set of clients with very differing investment objectives and which have their own proprietary investment positions. But Goldman's conduct in misleading its clients, as alleged in the complaint, cannot possibly be excused as an innocent mistake. If the SEC's allegations prove to be true, how can institutional investors, like the Dusseldorf commercial bank to which Goldman sold the ABACUS deal, possibly consider doing business with Goldman?

Firms in the securities business--big ones like Goldman and small ones like Core--have various assets, but certainly the indispensible asset is the firm's reputation for integrity and honesty in dealing with its clients. In my dealings with Goldman since I began as young lawyer on Wall Street more than three decades ago, in my acquaintance with lots of Goldman people over the years, in my observations of their work, I have been an admirer of the firm. I have felt that however tough-minded they were in their work, they made a (generally successful) effort to do the right thing by their clients and customers. Unless the set of facts is entirely different from what is portrayed in the complaint, Goldman has done immeasurable damage to its reputation and to its business.

By

Jack Mayberry

The Goldman story will unfold further, and a fuller account of how CDOs were developed and marketed lies ahead. We will not lack subject matter for these letters.

Goldman's statement on Friday makes the point that the SEC complaint addresses a "single transaction". However, Goldman has proudly reported that its very senior executives became wary of the subprime market in 2006 and 2007 and changed the firm's investment positions in mortgage-related securities, so that the firm could benefit from the weakness it foresaw. It is almost certain that its senior executives, including Lloyd Blankfein, the CEO, and David Viniar, its CFO, were closely involved with the activities of the firm's unit that created the ABACUS CDO.

What else may we learn in coming months about Goldman's dealings in the subprime disaster? The Senate subcommittee chaired by Carl Levin has been investigating the unraveling of the financial system for many months; it has broad subpoena power, which it has been using in a concerted way. At least seven other large investment banks have received subpoenas from the SEC relating to creation and marketing of CDOs and other structured products. The Paulson hedge fund was not the only investment firm seeking the creation of mortgage-related securities by investment banks for purposes of shorting that market. It is entirely likely that the investigations will yield more civil charges--perhaps criminal ones, as well.

Goldman is an important firm and the SEC complaint against it provides an interesting story. The fundamental issue, though, is not the future of Goldman, but the soundness of America's banking system. The devastating financial losses and the horrible recession arose from failures in regulation and structure of the system. The very lax regulatory regime and the fantasy of self-regulation permitted dangerous mortgage underwriting practices and sales of devilishly complex derivative products. We can now see that these practices and products gave rise to terrible losses for the unsuspecting and unseemly gains for the financial insiders. That some of the gains arose from corruption and fraud has already been established; whether this CDO in the SEC's complaint was an instance of fraud has not been established. New regulatory schemes are near the top of Obama's agenda; the opposition to the developing legislation, by Republicans and by the banking industry, is implacable. The Goldman complaint may mark a new step in the political process, by shining a narrowly focused light on the way these products were developed, marketed, and used. Resistance to a sensible regulatory scheme may be more difficult for Republicans in the face of these allegations and the perception that Goldman and other big firms were rigging the system.

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Core's investment activities. Apart from reading the financial press, we have been making some investments. Last week we sold a portion of our high-grade US corporate bonds, and with the proceeds are purchasing a position in high-yield US corporate bonds and in Dutch equities. There is nothing wrong with our high-grade corporate bond investments, except that, as bond prices have risen, the scope for further capital gains becomes ever smaller. Meanwhile, the lower-grade and higher-yielding sector of the bond market still has room to gain. As the economy improves, so do already-strong corporate balance sheets. Thus, the low-grade bonds become less risky, while still yielding more than 8 percent. As for our investment in the Netherlands, the unfolding crisis with Greek sovereign debt has driven down stock prices even in the very strong European countries like The Netherlands and Germany. We see value in Dutch equities.

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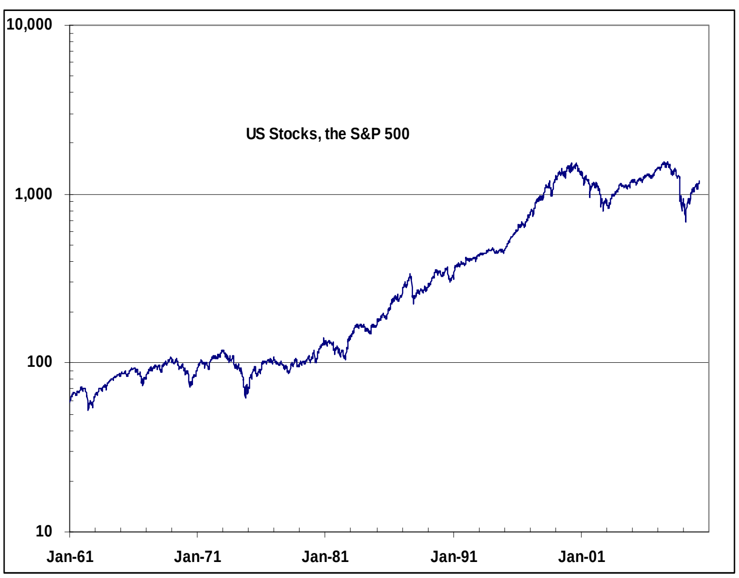
CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

April 7, 2010

Structural Changes and the Cyclical Bull Market

The long-term, logarithmic-scale chart of the S&P 500 shows the 'secular' bull market of the '80s and the '90s. Did a new long-term bear market begin in 2000?

The financial crisis and recession have made lasting changes in the ways that people and companies and governments act, changes that may become manifest over the next decade and more. These changes will have long-lasting effects on investments, requiring Core to adjust its practices to align the capital we manage with the new reality. Without discussing the nature of the changes in a detailed way, I wish to touch on some of the issues and point to changes we have made in our investments. Within the long-period changes, our investments must be consistent with the still-young cyclical bull market that began in March of last year. This letter will attempt to describe the interplay between the long-term and the cyclical forces.



De-leveraging in the private sector. The crisis followed a decades-long process of increasing indebtedness in the world. At least since the early 1980s, the private sector--people and companies--took on more debt, as credit became easier to access and lending standards fell. The final wave of the process involved huge increases in mortgage debt in the United States and many other countries in the developed world, along within the unsustainably large increase in house prices. Much of the world's economic activity since the early 1980s derived from borrowed money. When home prices began to fall in 2007 and mortgage-backed securities lost value, the global financial crisis was on, with the nasty features we remember so well. One immediate consequence was the effort by the private sector to reduce debt, to 'de-leverage'. A good part of the de-leveraging is accomplished by saving more and spending less, which process may go on for years. As companies and individuals clean up their balance sheets and reduce indebtedness, the lower rate of spending may result in slower rates of economic growth than in years past. In particular this is likely to be the case in the developed economies of Europe, Japan and North America.

As an investment matter, we might expect that the United States will be generating a larger portion of its income from export activities and a smaller portion from consumer spending. Indeed, it is entirely possible that Asian consumers in the rapidly developing economies will be saving somewhat less and spending more, providing a counterbalance to the reduced spending and increased saving in America.

By

Jack Mayberry

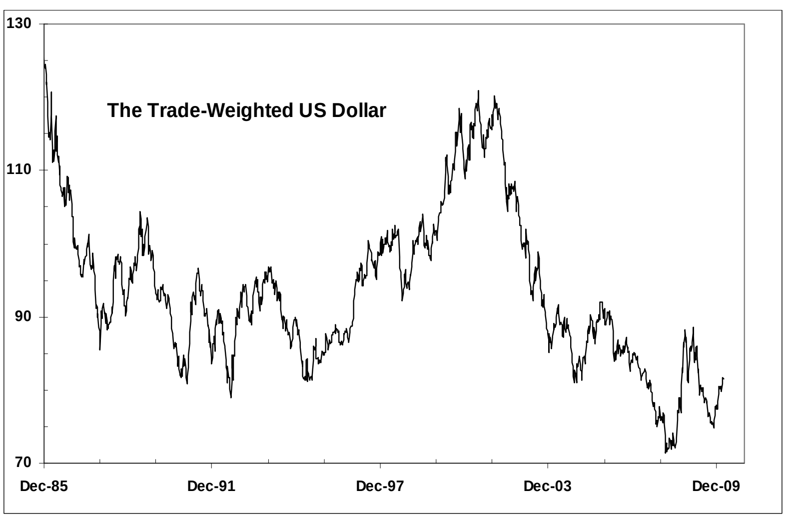
As the consumer sector of the United States becomes proportionally smaller than before, and *the export sector somewhat larger, the investment focus shifts toward those sectors in which productivity gains are greater. US economic growth will increasingly depend upon higher productivity. For a number of years, the productivity of the US labor force (the quantity of goods and services produced per unit of labor) has grown at a much faster pace than in Japan and Europe. This is the most reliable source of growth for the United States.*

The crisis with the Greece and the euro marked the beginning of an upturn in the value of the dollar against its major trading partners.

For the sake of US exports, US policy makers would prefer an 'orderly' decline in the dollar's value. At present, China and the United States are expending a good deal of diplomatic energy around questions of the exchange rate between the dollar and the renminbi. The United States (and most other countries) want China to allow its currency to appreciate.

To the extent Americans increase their savings, so will grow the demand for high-grade fixed-income investments. We may expect this to favor high-grade bonds and the stocks of financially strong companies with relatively high and growing dividends.

Increased debt in the public sector. As economies contracted very severely in the second half of 2008 and the early part of 2009, and the world tottered at the brink of financial and banking system collapse, the public sector--governments and central banks--stepped forward to preserve the banking system and to forestall depression. Governments vastly increased their levels of spending for unemployed workers and in projects to stimulate economic activity. The increased spending took place against the backdrop of collapsing tax revenues, so that public deficits soared. Meanwhile central banks and the public treasuries took on a huge range of housing and banking-related assets, to support the collapsing financial system. Thus, as the private sector has been de-leveraging and reducing debt, the public sector has increased its debt and its deficit spending. It is almost certainly the case that, if governments had been unwilling to increase deficit spending and to take on dodgy mortgage-related assets, the global recession would have been far worse, and the human suffering from the financial crisis and recession would have been much, much greater than it has been.



However useful and however well-intentioned has been the public sector response to the crisis, the world now finds itself in the situation in which some governments have far exceeded the amount of spending and borrowing their economies can support. Greece is one of these; we addressed its slowly unfolding and somewhat insuperable problems in our last letter. Some other countries do not face a crisis now, even those with very high deficit spending. The United States is one of these. However, problems for America and others lie ahead, because future payments which the country has promised to make may well exceed its funding capacity. The analysis involves consideration of a country's present outstanding debt, the so-called 'structural deficit' (including the projected costs that arise from unfunded future obligations), economic growth rates, and demographic balance. A favorable demographic balance is one with lots of young working people and not too many old, retired folks. The United States has had a far better demographic balance than Western European countries and Japan, in significant part because of fairly open immigration policies that encourage young, ambitious, hardworking people to come to the United States. To the extent the somewhat ugly anti-immigration politics of the last decade and more slows the flow of immigrants, our demographic balance worsens and the future for our public finances looks somewhat bleaker.

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These public finance issues raise questions about capital preservation. Long-term US treasury bonds appear less attractive, although short-term US debt seems as secure and safe as ever. The United

Kingdom faces problems at least as bad as those of the United States, but it benefits from a very long average maturity (about 11 years) of its public debt, as against less than 5 years for the United States. Thus, the UK has a bit less debt to roll over than does the US. Germany and the Netherlands are in a stronger position, making their long-term debt more attractive than US debt.

Sentiment against 'globalization' and the process of re-regulation, particularly in the banking sector, may be impediments to stock markets now and in the years to come.

Several of the developing Asian countries have a strong public finance position, favorable demographics, high economic growth rates and large current account surpluses. In broad terms, the bonds of a number of these countries are very attractive investments. We have positions in these now, and expect to build them further.

Anti-globalization. In recent years, 'globalization' has been ascendant. This broad and somewhat vague term comprises different features, including the relatively free flow of capital around the world, the adoption of market economies in the developing world, the development of securities markets in countries of any economic significance, the general support for liberal economic policies and relatively free trade in goods and services. Many of these features are now a settled part of the landscape, but there are counter forces now to globalization. The sudden and sharp collapse in global trade at the end of 2008 is now being reversed, but trade and currency disputes threaten protectionism. New government intervention in previously un-regulated private activity runs counter to the free movement of goods, services and capital across national borders. At the very least, globalization is no longer viewed (if it ever was) as a panacea to the world's economic ills.

One aspect of globalization has been the growth in stock and bond markets in the developing world. This has occurred to such an extent that some of these markets have become quite expensive, requiring more selectivity in our investing in these markets. And if, just to give one example, the ongoing currency quarrel between the United States and China does not find a reasonable, face-saving resolution, new tariffs and other impediments to trade may well develop. Similarly, the anger--well founded or not--toward bankers and hedge funds for the various aspects of the financial crisis may foster ill-conceived policies that worsen economies and investment markets.

The very long term chart of the US stock market on the front page of this letter shows the two-decades long stagnation in the US stock market in the '60s and '70s, followed by the secular bull market of the '80s and '90s. We are clearly in at least a small-scale cyclical bull market now after the crushing bear market of 2008 and the beginning of 2009, but probably not within the context of the long-term 'secular' bull market.

Re-regulation. Finally, because governments and central banks had to intervene in 2008 and 2009 to prevent the collapse of the banking system and to mitigate the effects of the terrible recession, there is a quite reasonable effort now to reshape the regulatory framework to prevent recurrence of the same problems. The question now is whether re-regulation will have a good effect on the system; the question is not whether there will be new regulatory schemes. This latter question is settled.

Our investment decisions must be made against the new and significant structural issues of less private debt, more public debt, less globalization, and more regulation. The investment implications of these 'structural' changes in the world are many and varied, they will unfold over the next decade and longer.

The Secular and the Cyclical. The issues discussed above relate to long-term changes. In the investment business, it is commonplace to analyze long-term developments, perhaps stretching over decades, and to refer to these as the 'secular' conditions. After the mid-1970s bear market, the oil price shocks of the 1970s, and the terribly high inflation and interest rates of that era, a 'secular' bull market began as Paul Volcker took charge of the Federal Reserve and unleashed his successful effort to bring inflation down. Bonds and stocks rallied enormously for years throughout the '80s and the '90s. The 'secular' bull market in stocks appears to have ended with the bursting of the tech and dot.com bubble in 2000. Bonds continued to rally in price (and bond yields fell) through the first decade of this century. The 'secular' backdrop has changed and the quite miserable stock market returns of the last ten years probably mark the beginning of a 'secular' bear market.

The interplay between the very long-term influences, at least some of which are negative, and the cyclical forces of the bull market that began last March, lead us to invest in high-quality bonds, some foreign currencies, and a narrower group of developing country equities. We are looking for an opportunity--i.e., lower prices--to make new investments in equities.

A shorter perspective is that provided by the investment cycle. In this 'cyclical' dimension measuring a few years or so, we would identify the dot.com bear market from 2000 to 2003 as the downward part of a cycle. A cyclical bull market began in 2003 and ended at the market's top in the autumn of 2007. Then unfolded the recent and devastating cyclical bear market, which reached its bottom in March 2009. At that point began the new 'cyclical' bull market. Regardless of long-term 'structural' headwinds, regardless of whether or not we are in a 'secular' bear market, the financial markets are clearly rising. (Within a 'secular' bull market, there are cyclical bear markets: recall the market crash in 1987. Similarly, a 'secular' bear market will certainly include 'cyclical' bull markets, like that from 2003 to 2007.) It is impossible to say when this cyclical bull market will come to an end, but, given the economic recovery (which looks increasingly robust and sustainable in the United States), given the recapitalization of the banking sector, given the enormous support by the Fed and the US Treasury for the economy as whole, it is likely that this cyclical bull market will persist for another year or two or more.

The interplay between the long-term 'structural' problems that shape this 'secular' bear market with the unfolding 'cyclical' bull market is tricky. Important forces discourage investment in stocks and commodities and the like, while the Fed's monetary policy, the ongoing support of the federal government for the economy, and growing industrial activity push higher the prices of assets that benefit from reflation, recovery, and economic expansion.

Core's approach is to recognize the structural and secular obstacles and allocate a large portion of clients' capital to high-grade bond investments, including US corporate bonds and short- and medium term bonds in developing economies. We think that the Fed and the Treasury will continue to seek a slow *depreciation* of the value of the dollar, especially against the Chinese renminbi. (News today suggests that a deal with China may be at hand.) We recognize, as discussed in our last letter, the almost insoluble problems with the euro, hence we focus our currency investments in emerging markets, and in the Canadian and Australian dollars.

We have a small position in commodities, including in gold, the former as a reflation and a dollar depreciation investment, the latter as a counter to the global trend to debase paper currencies. We have narrowed our emerging market equity investments to Hong Kong, Taiwan, Indonesia and Brazil. Our American equity investments are in the large technology companies, regulated utilities, and the oil industry. (Other sectors appeal to us now, but, after several weeks of a stock market rally, we prefer to wait for lower prices.) Even after this full year of exceptional gains in stocks, we expect stock prices to move higher in the next two years, but at a more subdued pace. After these several weeks of modestly higher stock prices, we await at least a bit of selling and more attractive prices, before we commit more capital to risk assets. The 'cyclical' forces are positive, but the long-term 'structural' and 'secular' forces impel caution and restraint.

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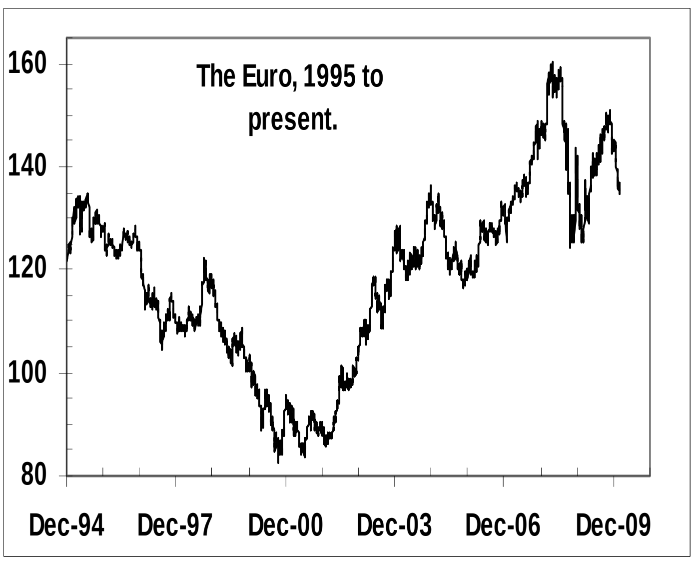
CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 11, 2010

The Core and the Periphery

The chart below shows the value of the Euro in US dollar terms. The anxieties relating the Greek government bond problem account for its recent decline.



By

Jack Mayberry

The clamor arising from the deteriorating position of Greek government bonds and concurrent, unrelated actions in Indonesia provide a fascinating paired lesson about the world as it is now. The lesson affirms the value of our years-long and still-growing investments in the developing economies. For many decades and until the last ten years or so, it made sense for conservative investors like ourselves to focus our investments in the developed economies of America, Japan, and Western Europe, and to make investments in the emerging markets only in good times and with our risk capital. The unfolding drama in Greece and other countries in the Euro-zone suggests that the developed Western economies may now be considered the risky ones, while the emerging markets provide the sounder and safer destination for our investment capital. Western economies used to be the 'core' countries for investing and the emerging markets the 'peripheral' ones. Increasingly, our 'core' investments will be in the developing world; investments in the Western economies may become our tactical and opportunistic ones.

Last week, Greece and its bankers sold about 5 billion Euros worth of new Greek ten-year government bonds. The reasonably successful auction would have been impossible before the events of the previous weeks: France and Germany signaled a willingness to support the Greek sovereign debt market, if Greece enacted a set of harsh new laws increasing taxes and cutting government spending. All of this has been effected under intense pressure from investment markets.

The incomplete Euro experiment. Among the odd features of the design of the Euro is that there is no European Treasury, no central government to support monetary aspects of the single currency. The Euro-zone countries created a single central bank, the European Central Bank, to set unified monetary policy for member countries, but there is no corresponding European Treasury to set fiscal policy and to attempt to co-ordinate fiscal and monetary policies. Authority for taxation and government spending remains with the individual countries. Germany makes its own decisions about taxation and government spending for Germans; Greece has made its own decisions for Greeks. (Imagine, for a moment, that the 50 states banded together to create the Federal Reserve and the US dollar, but did not set up a federal government, so that there was no

While economic conditions were strong and financial markets favorable, the Euro's structural problems could be—and were—ignored. With the financial crisis and deep recession, it has become clear that different countries within the Euro-zone present different risks.

The chart below shows equities in the emerging markets. The financial position of several Asian and Latin American countries is far stronger than among that of Greece and some other European countries.

Treasury department, no national government with its own tax base and spending powers.) Germany has been fiscally responsible; Greece has been profligate and fiscally irresponsible. The crisis has arisen because Greek government spending has far outpaced its revenues from taxation. Worse, the amount of government debt as a percentage of Greece gross domestic product is so high as to make seem somewhat unlikely that all interest payments and principal repayments can be earned from the future growth of the Greek economy and the portion of that economy that flows to the Greek treasury.

Sovereign bond prices. When the Euro was created and later as more countries took up the Euro in recent years, the markets treated the government debt issued by the individual Euro-zone countries rather equally. Thus the yield on Italian government debt was essentially the same as the yield on German debt of the same maturity. As countries like Greece joined the Euro, the yield on the new-entrants' sovereign debt began to 'converge' to the levels prevailing for German debt. Thus, the markets were pricing Euro-zone sovereign debt as if all the countries were equally credit-worthy, or as if there were an implied guarantee that the rich and fiscally conservative countries like Germany and the Netherlands would stand behind Irish, Greek and Italian debt. One measure of the rather too-sanguine view that markets took before the crisis is that, in 2007, it cost $5000 a year to insure $10 million of Greek sovereign debt against default. Earlier this year, the cost had risen to $425,000. This crisis makes it abundantly clear that all Euro-zone countries are not equally credit worthy; the so-far unanswered question is whether the rich countries will support their profligate neighbors.

The failure of Maastricht. Euro-zone countries entered into a treaty in 1992 adopted at Maastricht. As amended, this treaty provided, among other things, that the individual countries would adopt and follow certain fiscal policies relating to budget deficits and government debt. As it turned out, countries have not met their fiscal undertakings. The absence of any real enforcement mechanism and the unwillingness of countries to take the needed political action to create a central fiscal authority and treasury have rendered moot and impotent important aspects of the Maastricht Treaty. Even before the crisis and recession, Greece and other countries had built up enormous deficits and incurred very high levels of debt. Then came the recession; tax revenues shrank, economies faltered, and spending to support the unemployed and to stimulate economic activity grew. The problems with sovereign debt could no longer be ignored.

Limited solutions for Greece. The difficulties Greece faces are not new; tens of countries have endured episodes like these in recent decades. None are easy for the countries involved, but the ways of working through them are fairly well-settled. Three principal avenues are open to most countries, involving currency policy, monetary policy, and fiscal policy. However, in the unusual situation facing Greece and the other weak, over-indebted countries in the Euro-zone, two of the three routes are cut off: Greece does not control its currency; it cannot

The challenges that face Greece are daunting. Without control of its currency or its monetary policy, it must fall back on tax increases and sharp cuts in spending. These actions will weaken its economy.

In this dilemma, the larger countries in Europe must step in to aid Greece, or risk the undoing of the otherwise very successful experiment with the single currency for Europe.

itself devalue the Euro; its economy and its bond market are too small. Monetary policy is also imposed on Greece from afar by the European Central Bank. In general, Euro-zone monetary policy has been designed for the central countries, especially for Germany and France. In the middle of the decade, when the 'peripheral' countries, like Spain and Ireland, were booming, monetary policy was looser than appropriate for them. Now monetary policy is too tight for the weakest Euro-zone economies, certainly too tight for Greek needs. So the fiscal solution is the only one available to Greece: it is obliged to raise taxes and to cut spending, especially for pension benefits and salaries of public-sector employees. These actions may worsen economic conditions in Greece, but they are necessary if Greece is to receive any kind of support from Germany or from the IMF.

Contrast Greece's situation with that of the United Kingdom, which itself has a somewhat shaky fiscal position. The British considered closely whether to join the Euro-zone at its creation. During the first years of Tony Blair's terms as Prime Minister, this was the biggest public question in Britain. Because Britain retained the pound sterling as its currency and the Bank of England as its central bank, it has had far more flexibility to respond to the financial crisis. The value of the pound dropped from $2.11 in November of 2007 to $1.37 in March of 2009, providing key support to its export industry. The Bank of England and Britain's treasury were able to co-ordinate activities (as, of course, did our Fed and Treasury) to forestall the collapse of financial institutions and to deal with the recession. Britain's problems are far from resolved, but, by virtue of control of its monetary policy and its freely-floating currency, it has more tools available to it than does Greece.

Although there is loud criticism by public officials and by German and Greek citizens about evil bankers, it is interesting to note that the exigencies of financial markets are accomplishing within Europe what was called for by the Masstricht Treaty.

Political will to keep public finances strong was lacking; the crisis is now forcing these changes.

Market forces bring about what Maastricht could not. Greece's actions, in cutting spending and raising taxes, are the kind called for by the Maastricht Treaty, actions that have not been performed from lack of political will. The general strikes going on in Greece show how unpopular these measures are and illustrate the political difficulties that hobbled the Treaty. The interesting irony is that market forces are now accomplishing what could not be done by the political process. Greeks are furious with the evil banks and investment funds and accuse them of exacerbating Greece's financial position. Officials in Germany and the United States are making similar arguments; Fed Chairman Ben Bernanke reported to Congress recently that the Fed is investigating whether certain derivative products have been used to weaken prices of Greek government bonds. However, there is a good argument to be made that present market prices for sovereign debt of Euro-zone countries now provide a fair measure of the differing levels of risk of default among the different countries. Ten-year Greek government bonds now yield something more than 6%, whereas ten-year German government bonds yield only slightly more than 3%. It is entirely reasonable for investors to demand an extra 3% interest payment to hold Greek bonds, which certainly are far more likely to default than are German bonds. The anomaly existed three years ago, when yields among government bonds of European government were fairly uniform.

A Euro crisis. Concern in recent months about sovereign debt has involved more than Greece. In the autumn, Dubai was unable to meet debt obligations;

its oil-rich neighbor, Abu Dhabi, helped out. Other Euro-zone countries are also in parlous fiscal shape, including Spain, Portugal, Italy and Ireland. Resolution of the Greek situation is thought necessary to prevent a similar funding crisis in one or more of those countries. The Euro itself has fallen in value during recent months, as we noted in our letter of several weeks ago. The Euro's structural problem of having one currency and one monetary policy for many countries, but no unified fiscal and taxing authority, has been laid bare by the Greek crisis.

National feeling is strong. Germany was prepared to spend virtually unlimited sums in the early 1990s, after the fall of the Berlin Wall, to support the former East Germany in reunification. But the same fellow feeling does not extend to Greeks, portrayed in the German press as profligate wantons. The value of the Euro against the dollar is a gauge of these problems. From $1.51 in late November, the Euro fell to $1.34 this last week. However, the fiscal problems in Greece, Spain, Portugal, Italy and Ireland are not amenable to easy resolution, particularly in the context of this very severe recession. The willingness of Angela Merkel and Nicolas Sarkozy to suggest that market manipulation by Goldman Sachs and hedge funds is the problem stokes popular anger on the streets of Athens and discourages support by the German public for a resolution. We may be in the early stages of a terminal crisis for the Euro.

While the Euro currency and many European government bonds fall in value, currencies and bonds in emerging markets are strong.

Core has investments in emerging markets bonds, as well as in stock markets in developing countries.

The Last Shall be First. By contrast with chaos in the old developed world, consider the situation in the developing world. The Asian countries that suffered such a dire recession as a result of the Asian currency crisis in 1997 and 1998 resolved to build their foreign currency reserves and to secure their financial positions. Many of these countries are financially strong, with robust, growing economies, good balances between tax revenues and spending by governments, and large current account surpluses. This last week, as the Greek melodrama (decidedly not a Greek tragedy) was unfolding, a farcical episode was playing in Indonesia, in which the parliament instigated a criminal investigation relating to a bank bail-out in November 2008. The targets of the investigation are the Finance Minister and the Vice President of Indonesia. The force behind the investigation is a rich financier, whose own financial institution had been denied a government bail-out.

This bit of political theater might be seen to threaten Indonesia's program of fiscal reforms. Ten years ago, such news would have caused capital to flee the country and its markets. The response to this episode has been a yawn: Indonesia's currency and stock markets have not blinked.

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Conclusion. The Greek sovereign bond crisis and the minor turbulence in Indonesia are two more illustrations about the way the world has been changing over recent decades. We are hardly predicting the demise of the Euro. But we see these events as emblematic of the shifts in wealth and power in the world. We have long recognized the growth occurring in the developing world and we have been investing increasingly large portions of your capital in the developing world. During the periods of favorable market conditions in the last decade, our principal investments have been weighted toward the developing economies. We expect to continue the approach in this decade.

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

January 25, 2010

Uncivil Discourse

The curdled political process in the United States is harmful to investments markets--and to the well-being of the country.

The complexity of America's problems demands nuanced discussion and co-operation. Instead, our political discourse is characterized by bitter partisanship, falsehoods and personal attacks.

By

Jack Mayberry

The week just past has provided proof--as if we needed it--that public discourse in our country is in a destructive downward spiral. President Obama's renewed attacks on banks and the Supreme Court's decision on campaign finance laws are striking reminders of how bad things are.

Aggressive partisan baiting has become the norm over the last decade; Republicans have long recognized political advantage in attacking their opponents, using truth or falsehood as political calculus determines which is more advantageous. In the first months of Obama's administration, it appears that Republicans made the tactical decision to oppose the initiatives of the White House and Congressional Democrats, without respect to the severity of the problems under consideration or the merits of policies proposed. Thus, for example, although most Republican office holders recognize that the American health care system is inefficient and expensive, the political calculus seemed to be that outright and unified opposition to the attempt at comprehensive reform of the system was expedient. Better to defeat Obama and preserve a screwed-up medical system than to cooperate with Democrats.

Having observed the souring public mood for its economic, financial and health care initiatives, the Obama administration has adopted much of the language and tactics of Republicans in its dealings with banks and attempts at regulatory reform of the financial system. After the striking Senate election in Massachusetts on Tuesday, the White House organized a brief speech by Obama on Thursday to announce the outlines of a plan to restrict certain activities of big banks. Obama pointedly referred to his willingness to fight the banks if they should oppose his plans. It reminded me of President Bush's language after the September 11th attacks and in the early stages of the wars in Afghanistan and Iraq, taunting Al Qaeda to "bring it on". Spoiling for fights ought to be well beneath the dignity of that office.

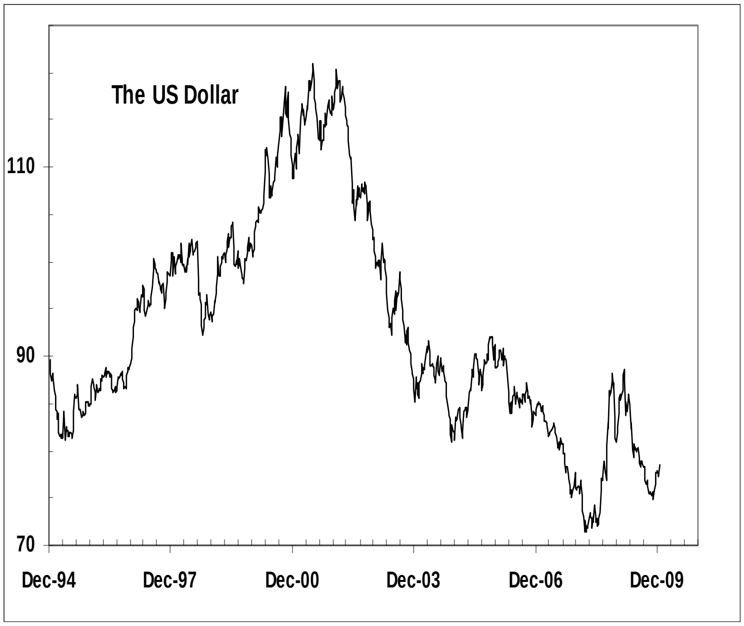
Last week, the Supreme Court struck down, on First Amendment grounds, long-standing campaign finance limits on corporations, overturning carefully-crafted legislation that sought to balance these First Amendment rights with an attempt to limit spending by big businesses in political campaigns. The likely effect of this ruling will be to amplify the strident voices and further to cheapen and coarsen political discourse. Our country faces complex problems, the amelioration of which is more likely in the context of civil public discussion. Civility and thoughtful debate are even less likely now.

For investors, stridency and belligerence are unwelcome. The miserable tone is hardly conducive to resolution of difficult fiscal, monetary, and economic

The US dollar may be in early stages of a recovery. We have sold our position in euros, but retain investment in other currencies.

problems or to reform of our woe-fully dysfunctional financial regulatory system. We have not fully finished with a financial crisis of unprecedented magnitude; further erosion in the functioning of our political system is destabilizing at best. Economic growth is unfolding; financial markets are recovering from their trauma; the central banks are providing very favorable monetary conditions for the markets and the economy. Would that the political environment offered support for economic growth and stable financial markets.

Currencies. As the markets pulled back from the abyss beginning in March last year, the value of the dollar began to fall against freely-floating foreign currencies. On a trade-weighted basis, the dollar fell by about 16% in nine months. Since Thanksgiving, the dollar has turned upwards in value, especially against the euro. It has remained weak against the other currencies in which we have investments, namely the Canadian and Australian dollars and against currencies of many developing countries that do not peg their currencies to the dollar. Fiscal problems with countries at the periphery of the euro-zone, especially Greece, but also Spain, Portugal, Austria and Ireland, present problems for the euro. The European Central Bank may need to retain its very low interest rates and quantitative easing policies longer than does the Federal Reserve. These factors suggest that the euro, which rose to $1.50 to the dollar in beginning of December, and now stands at $1.41, could fall further in the months ahead. We sold our large euro position in stages beginning in late November. It is an open question, and a matter we consider closely, whether a continued rise in the dollar's value will damage a number of other investments we hold, including our remaining currency investments, commodities, and emerging market equities.



Trading and transaction costs. In conversations with some clients recently, I was asked about the relatively high number of trades Core has been making. It is quite true that I have felt obliged to make changes to our portfolios at a greater rate since the financial crisis began than previously. The uncertainties, risks to the banking system, shifting policy responses, and extremely high levels of volatility have been behind these tactical investment moves. We at Core have no wish to trade your capital actively; it is very time consuming for us and, as you know, Core realizes no benefit from greater activity. Our dual responsibility, to protect and to increase your capital, has caused us to trade more actively during this crisis. When placid times return, we will certainly be able to make longer-term investments.

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In this connection, it is worth noting that Schwab has recently reduced its commissions to $9 per trade for all accounts that authorize electronic delivery of statements and trade confirmations. Previously, this $9 rate was available only to Schwab customers with a total of $1 million in their Schwab accounts. For accounts requiring paper statements and confirms, commissions range from $13 to $20. We will contact all Core clients who still receive paper statements, suggesting the switch to electronic delivery.

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