Two Weeks Into the New Year, Where Do We Stand?

Fourth Quarter 2007

We are now two weeks into the New Year and it is clear that the U.S. markets are on shaky ground. Since August when the subprime mortgage chaos started to effect the markets there have been three separate occasions when the S&P 500 lost approximately 10% from peak to trough. In the past a decline of this magnitude has often been used to define a correction. Since we have not seen a corrective move in the market in five years this alone should not be seen as a major problem.

However, what is causing stress is the lack of transparency by the companies that caused this problem and by the pressure placed upon the economy by rising commodity prices and the slowdown in consumer spending. The big unanswered question is whether or not we will have a recession. Until that issue is resolved there will be no stability in the U.S. markets.

How will that affect us? First of all we are in a marathon not a sprint; we should always expect some stretches in our long term race to be difficult. For most of you we are holding more cash than ever before, we also have positions in commodities, inflation indexed bonds and foreign bonds which are currently doing well in these turbulent times. The cash not only gives us a cushion it also leaves us with money to invest at better prices. The rest of our hedging strategies could lower our overall investment volatility compared to the market as a whole. This does not mean that we will make money; it only suggests that we might lose less. Remember I have never suggested that timing the market is possible only that if we stay with our basic philosophy we can make more money for you by losing less in a down market and not taking too much risk in an up market.

The housing problem is not finished nationwide, it is clear that as Citigroup reported record breaking losses and Merrill is looking for foreign investors the companies behind the securities that support subprime lending are having major problems. Corporate layoffs might be in our future. Our primary course of action is to keep making minor adjustments to your investments and patiently wait for better opportunities ahead. You should always remember that you are invested for the long run not the short term.

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