

July 5, 2008



Client letter,

Our book-of-business annual rate of return on stocks the last quarter was 48%, compared to -8% for the Russell 3000. While that rate of return ranks number seven over the Wenzel Analytics' 26 quarters, it ranks number one in beating the index. All of which is scary, given the volatility of the market. We are heavily tilted towards energy, basic materials, commodities and the services related to these sectors. We are also heavily in investments where the underlying security is not based on the dollar. This has served us well, but if the heavy infrastructure investment of the emerging countries would reverse, if the price of oil would collapse, or if the dollar would suddenly strengthen for an extended period, we would have to make some changes.

With the dramatic increases in the price of oil, along with the United States trade and fiscal deficits, the US economy is and will be going through some wrenching changes. Many people are at a loss for how to respond, and because of inflation and market declines, will incur significant losses. Others will find opportunities for significant gains. I see it as a dangerous time to be in either fixed investments or market indexes. A prolonged period of inflation at 7% or higher, which the shadow statistics say we now have, dramatically impacts the wisdom of holding 3% and 5% fixed income investments.

In thinking broadly about future financial security, having money in the future comes down to two sources. One is from things we can sell, such as our skills and time, our tangible assets such as our house or possessions, or our intangible assets such as stocks and funds. What we can sell anything for in the future is dependent upon the market at that time. Who wants to buy it? What can and will they pay? The other source of future money is from what someone promises to pay us. That may be in forms such as CDs, bonds, pensions, immediate annuities or social security. Are they able to keep their commitments and will they?

For all of you I manage the allocation within the dollars you have placed under my stewardship. I have a general idea for how what I manage fits within your total picture, but for none of you do I have current data regarding your other assets. Since none of you have financial planners (to my knowledge), and I am not your financial planner, I would encourage you to extend the pivot tables and charts found in the reports I send to you to encompass your total net worth. If you are not familiar with or have access to the software, I would be happy to assist. You can get there without such tools, but it makes it easier and easier to keep current. It is not a time to go forth boldly into that dark night...

The country and regional ETFs are down, alongside the US market, even as their respective economies are thriving. The relationship between a country's economy and its stock market is often over-estimated. People try to read the tea leaves on the economy as if the economy directly correlated with the market. Even the adage that the market leads the economy by six months does not have a strong statistical foundation. I do think the country and regional markets will increasingly unhook from the US markets and respond to their respective economic conditions. However, sector and industry matter more than country.

I have been spending my time trying to keep a solid bigger perspective as well as attending to minutia of balancing and rebalancing 1,400 positions. I spent four days at the Las Vegas Money Show sorting trash from treasure. I attended an interesting and provocative 3-day national conference on media reform at the Minneapolis Convention Center. I read a book by Paul Collier [The Bottom Billion](#): Why the poorest countries are failing and what can be done about it. It is the most illuminating book on economics I have come across since my college freshman econ text. Vitaliy Katsenelson in [Active Value Investing](#): Making money in range bound markets, presents compelling data to argue that we will have a protracted period of the market bouncing up and down but going nowhere. He has agreed to come speak to our AAI chapter next spring. If he is right, we are either dependent upon markets other than the US or option spreads, which I am in the midst of exploring.

So both I and the business are thriving on the challenges offered. Thanks for your trust, and call if you have questions or want to get together.

Sincerely,

***An alternative to mutual funds.***

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