

Weekly Commentary March 24, 2008

The Markets

They say truth is stranger than fiction and last week's mind-boggling activity in the financial markets underscored that point.

Investors awoke to the news last Monday morning that investment bank Bear Stearns, which just a few days earlier had been trading for more than \$60 per share, was being sold to JP Morgan Chase in a Federal Reserve orchestrated bailout for a mere \$2 per share in order to avert a possible meltdown in the financial system. Without the takeover, the Fed and Wall Street analysts figured Bear Stearns would have to file for bankruptcy, and the Fed decided they couldn't let that happen according to a March 18th, *Wall Street Journal* article. Despite a scary start, by the end of the day, the Dow Jones Industrial Average had managed a slight gain.

By Tuesday, euphoria gripped Wall Street and stocks soared to their fourth largest one-day point gain in history, according to MarketWatch.com. With the Federal Reserve cutting a key interest rate by three-quarters of a percentage point, many investors started to think that the worst was behind us.

On Wednesday, investors had a change of heart and the Dow promptly dropped nearly 300 points. As if in sympathy, oil prices, which had recently cracked \$110 per barrel, suddenly reversed and took their biggest one-day hit in more than 16 years. And gold, the shiny yellow metal, lost some luster, too, as it dropped more than \$60 an ounce – its largest one-day decline in nearly two years, according to MarketWatch.

With our heads still spinning, the Dow closed the week on Thursday with a 261-point gain, “as investors snatched up bargains and covered short positions at the end of a chaotic week, buoyed by economic data that wasn't quite as soft as expected,” according to TheStreet.com.

So, what's the final tally? For the week, the Dow ended up with a much-welcomed 3.4%. Are we out of the woods now? Nobody knows for sure, but one thing we may take some comfort in is the willingness of the Federal Reserve and the government to step in and help support the markets. Some people suggest that the government is meddling too much and that it's trying to circumvent the normal business cycle. Whether that's true remains to be seen, but for now, investors perceive the Fed and the government's intervention as comforting, not concerning.

Returns through 3/20/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	3.4	-6.8	-1.0	5.4	8.3	3.3
Nasdaq Composite	2.1	-14.9	-7.8	4.0	10.0	2.4
Standard & Poor's 500	3.2	-9.5	-7.4	4.0	8.7	1.9

Sources: Yahoo! Finance, Barron's. Past performance is no guarantee of future results. Indices are unmanaged and cannot be invested into directly. Three-, Five-, and 10-year returns are annualized. Assumes dividends are not reinvested.

AS THE FEDERAL RESERVE CONTINUES TO STIMULATE THE ECONOMY by lowering interest rates and easing lending requirements, we need to keep an eye on inflation. On March 14th, the Labor Department reported that the consumer price index was unchanged in February (that's good news) and rose 4.0% for the 12 months ending February 2008. The flat inflation

reading for February was lower than expected by many economists, according to a survey by Bloomberg News. Surprisingly, the Labor Department said energy prices *declined* 0.5% in February and the cost of electricity declined by the most since December 2005. That may turn around in March since crude oil prices recently topped \$100 per barrel and gas prices are well over \$3 per gallon and approaching \$4 in some places around the country.

When the supply of money increases in the economy (i.e., there's increased liquidity), Economics 101 says inflation may rise. If the growth of "dollars" in the economy outstrips the supply of goods and services, it may cause consumers to bid up the price of these goods and services, and hence, lead to inflation. A little inflation – and by that we mean 1 to 2% per year – is fine. When inflation starts creeping into the mid single digits area, problems can crop up such as high energy prices and a depreciating dollar.

The dramatic rise that we've seen over the past few months in energy prices, certain food commodities and precious metals can be partially attributed to the fear that inflation will rise out of the Fed's comfort zone. The weak dollar is also partially attributable to the fear of U.S. inflation. As investment managers, we have to keep in mind that the Fed's liquidity moves may keep the economy from falling into a deep recession (a good thing), but it may also keep energy prices in record territory and may make imports more expensive.

Due to the complexity of the global economy, it seems as if nothing is neutral. Making a change such as lowering interest rates may help certain parts of the economy, but it may be at the expense of a strong dollar and at the expense of consumers who have to pay more for energy and imports. The Fed is walking a tightrope right now. If they lower interest rates too much (i.e., the short-term rates that the Federal Reserve controls), it could backfire by causing inflation expectations to rise. If investors perceive inflation will be a problem, they'll push up long-term interest rates that are outside of the Fed's influence and that could thwart the economic growth that the Fed is trying to engineer.

Nonetheless, a quick glance at the headlines shows that even though stocks are down this year, other asset classes are rising. Traditional asset classes like government bonds are up this year through March 20th, according to Morningstar, as are alternative investments such as energy, grains, and precious metals, according to Barron's. With all the investment options available today, we try our best to have exposure to those asset classes that are working while keeping in mind each of our clients' goals, objectives, and risk tolerance.

Weekly Focus – Customer Service Champs

If it seems like customer service is on the decline across the country, you're right. A new report from Business Week, using survey data from J. D. Power & Associates, indicates customer service declined in 2007. All is not lost though. Here are the 2007 customer service champions, according to the report:

1. USAA
2. L. L. Bean
3. Fairmont Hotels & Resorts
4. Lexus
5. Trader Joe's
6. Starbucks

Do you have any great customer service stories that you'd like to share?

Best regards,