

Weekly Commentary June 2, 2008

The Markets

How do you succeed as an investor? According to legendary bond manager Bill Gross of PIMCO, “Investment success depends on an ability to anticipate the herd, ride with it for a substantial period of time, and then begin to reorient portfolios for a changing world.”

Essentially, Gross is saying, “find a trend and throw yourself in front of it.” The trick is to spot the trend early then move out of it before it fades away or, worse yet, crashes. Over the past 10 years, we’ve seen a few trends. For example, we had the tech stock boom of the late 1990s, the real estate boom of the early 2000s, and, now, the commodities boom over the past couple years. The first two trends ended badly, while the jury is still out on how the commodities boom will end.

As a financial advisor, we’re constantly scanning the horizon to try to identify trends and turning points in trends. When we identify a trend, we try to position your portfolio to take advantage of it. When we suspect a trend is starting to end, we try to adjust accordingly. Of course, no financial advisor will ever be 100% accurate, but, the good news is, we don’t have to be. You can still have a very successful financial result even with the occasional bad investment.

The key is to construct a portfolio that is diversified and that offers a chance of at least several components going up in value at any given time. Innovation in the financial sector now allows us to invest in areas that previously were difficult to access. That’s good news because we now have more asset classes from which to choose. With greater choice, we have more opportunities to find an asset class that may be starting an upward trend.

While the innovation is great, it does carry a price. Wall Street financial engineers got fancy and created sophisticated derivative products, such as collateralized debt obligations (CDOs), that are now coming back to haunt them. As a result, they discovered the hard way that if you don’t know what you’re doing, Wall Street can be an expensive place to learn.

It may not feel like it, but the trend in the stock market is up. Since reaching a recent low of 1273 on March 10, the S&P 500 has risen to 1400 as of last Friday, according to data from Yahoo! Finance. That’s a gain of about 10% in less than three months. While impressive, we’re not getting complacent. Like an airplane flying at 35,000 feet, we could hit unexpected turbulence at any time so we’re trying to stay vigilant on your behalf.

Returns through 5/30/08	1-Week	Y-T-D	1-Year	3-Year	5-Year	10-Year
Dow Jones Industrials	1.3	-4.7	-7.5	6.5	7.4	3.5
NASDAQ Composite	3.2	-4.9	-3.5	6.8	9.6	3.7
Standard & Poor's 500	1.8	-4.6	-8.9	5.5	7.8	2.5

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 YOU WELL KNOW, GAS PRICES HAVE RISEN DRAMATICALLY LATELY.

Where’s the cost increase coming from? In mid-May, crude oil, which accounts for 55% of the price

of gasoline, surged to an all-time trading high of \$135 a barrel. Accordingly, gasoline prices, which for months lagged the big run-up in oil, accelerated upward, fueled by the summer travel season.

High gas prices are just the tip of the iceberg. The rising price of oil, up 25% in the first quarter of 2008, negatively impacts macroeconomic variables from real GDP growth, inflation, and employment to exports/imports and interest rates. In fact, the Energy Information Administration (EIA) estimates that every \$10 per barrel increase in the price of oil will reduce U.S. GDP by approximately \$6.9 to \$13.8 billion in current dollars.

What's causing high oil prices? According to, *High Oil Prices Have Significant Effects on Consumers and the U.S. Economy*, published by Congress' Joint Economic Committee, rising oil prices are the result of "decisions made by OPEC and other oil-producing countries, stagnant production in Iraq, and ongoing concerns about political and supply stability in a number of oil-producing countries." What's more, since oil is denominated in U.S. dollars, the dollar's 40% decline in the last six years has put additional upward pressure on oil prices. And, because oil prices are affected by oil futures which are traded on the commodities futures exchange, prices also have been driven up by the increased speculative buying by institutional investors from pension funds to university endowments that own the largest share of outstanding commodities futures contracts. Yet, the most significant, long-term factor driving oil prices higher may be the greatly increased demand for oil in developing countries such as China and India.

While experts believe the combination of our nation's increased energy efficiency and the changing composition of output means that the U.S. economy is less vulnerable to high oil prices than it was during the oil crisis of the 1970s, high prices still can have a negative impact on economic growth because of their effects on producer costs. For example, as the price of oil drives the cost of gasoline higher, transportation costs rise, increasing the prices of goods and services. If those costs can't be passed along to the consumer, unemployment and subsequent decreases in production may result.

As Raymond L. Orbach, Under Secretary for Science at the U.S. Department of Energy, noted in a recent keynote address, that because global energy consumption is expected to double, perhaps triple, by the end of the century, we should find ways to supply new energy. To adequately meet the energy demands of the future, Orbach says "transformational breakthroughs" are needed to provide a foundation for novel, alternative technologies. He believes major advances could be on the horizon because of the emergence of nanotechnology, which could lead to revolutionizing the way energy is used, stored, and transmitted.

Just as the rise in oil prices in the 1970s led to significant breakthroughs in energy efficiency and alternative fuel production, so, too, will today's oil spikes foster scientific exploration and innovation. In fact, because the supply and demand curve may drive prices higher throughout the 21st century, we likely will see significant developments in the field of alternative energy sources, many of them driven by the cyclical nature of the oil industry.

Weekly Focus – "Staycation" Anyone?

With high energy prices and people strapped for time, some folks are now opting for "staycations." Instead of traveling to a far away destination, they're opting to stay close to home. It could be as

simple as spending a few days at home in the hammock or going to a local resort for a romantic escape.

If you have any exciting “staycation” ideas, let us know!

Best regards,

The Advocate Group

P.S. Please feel free to forward this commentary to family, friends, or colleagues. If you would like us to add them to the list, please reply to this e-mail with their e-mail address and we will ask for their permission to be added.

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