



Capital Ideas

Now It's the Same Old Song But With a Different Meaning Since You've been Gone

I had a call from a client (who is also a friend) a few weeks ago. He had the nerve to tell me that the humor had been lacking in recent newsletters. Unfortunately, I had to agree with him.

I know that we are supposed to remain confident in the workings of the market and always present a positive front. You want us to tell you that everything will be alright.

And that is true. Recessions come and go. The market is resilient. We just had a nice bounce in the second quarter. The capitalist system (actually the US economy is a form of welfare capitalism) has proven to be the best at wringing productivity out of the work force and creating wealth among a broad spectrum of society.

Everything will be OK. Life will go on. Babies will be born. The aged will pass on. New industries will start. Old industries will die.

Yet I feel a certain ennui. It is not just this recession. It is the lost decade.

I look at client accounts every day. Some are new clients. Some have been with us over 15 years. I do not know every client personally, but I know one thing about every client: There is a purpose for the assets placed with Capital Advisers. It may be for education of a child. It may be for retirement. It may be intended for

countless different things. Whatever the objective is, it is important to you.

That is the way we approach investing your funds. Our primary goal is preservation of capital. As Shelby Davis once said, investors make most of their return during recessions. They just don't realize it until after the recession is over. It is more important for your portfolio's long-term performance to preserve capital during market declines than it is to shoot the moon during bull markets.

This market simply has been difficult to work with. Last fall, the only investment that worked was US Treasuries. This year, they have done nothing.

Equities had a big bounce in April, but remain 40% below the October 2007 peak. That is something to get excited about! It now looks like the Dow will trade in a range between 8000 and 9000 for the foreseeable future (How is that for hedging your bets? The foreseeable future in the market is about 5 minutes. Still everyone wants to know about "visibility.")

The US economy is so dependent on consumer spending. The question is when will they return to the shops. The answer is that consumers will return when employment picks up and retailers adjust to the new reality. Without the wealth effect of rising home values and readily-available credit, consumers will not consume at the rate and prices that were prevalent prior to the recession. I am in the market for a new vehicle—my lease is expiring. When I visit dealers' lots, I am usually the only (potential) customer there. You would think

that they would try to come up with a deal that would move me to buy. They don't. Like any responsible shopper, I do my homework before I step on the lot (check out www.truecar.com, Kelly, Edmunds, etc.) Everyone comes back with an offer at or near the sticker price. That just goes to show you what government backing has done for the auto industry. They have capital (tax dollars) to stay open, yet they won't adjust to the changes in the consumer's purchasing power. Other businesses are beginning to adapt - but reluctantly.

Foreign investments are the darling of the financial media. Everyone should raise their allocation to foreign securities to 40% or more of their portfolio. Why not? If everyone sees only gloom and doom at home, it has to be better somewhere else. Look at the BRIC (Brazil, Russia, India, China) countries. They are rich in resources and cheap labor. Surely they will be resilient to this economic collapse. They will be the first to rise from the ashes. Please, give me a break. If you have a 50-60 year time horizon on your investments that might be a wise play. But over the next ten years they will suffer along with the American consumer.

Bonds have been interesting. There is no consensus on where interest rates are

headed. Logic would suggest that with the US and other governments borrowing so heavily there would be mounting upside pressure on rates. That probably will happen, but no one knows when. It could be next year or five years from now. Right now, a five-year Treasury will get you 2.41%. Then, if rates rise, your principal will tank. That is an exciting prospect. If you buy a five-year or better Treasury bond today, you will probably be holding it to maturity.

How about cash? Money markets are now paying 0.01%. That is not an error. It is not one percent. It is 1/100 percent. On top of that, the banks will tell you that they are subsidizing that rate!

CDs are better than that. Sure, if you don't care about the stability of the bank where you buy the CD. The best rate I could find on a 6-month CD was 1.9%, but I have never heard of the bank. By comparison, the comparable rate at Wells Fargo is 0.60%.

Then if you enjoy rollercoaster rides, there are commodities. Enough said.

Finally, there is real estate. I don't think prices have hit bottom. I don't have a crystal ball, so I could be wrong. But, I like to have more confidence in where I put your money.

That is why I can't get the old wit going. I know we will get through this. I know there

are better times ahead. I just don't know when.

I also know that there are hungry people in our industry who will whisper sweet nothings (and I mean NOTHINGS) in your ear to persuade you that there are better options for your investment dollars. *C'est la vie.*

As we go through the rest of this cycle, analyze what you see, read, and hear. If someone offers you a guaranteed return that actually sounds good, think Allen Stanford. If they offer you an investment program that has surprisingly low volatility, think Bernie Madoff.

I apologize for the lack of humor. This recession is real. Your goals are real. We are dedicated to getting you through this market cycle.

Thank you for your patience.



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